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Insolvency Law in the Czech Republic and in the USA

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D e c l a r a t i o n o f a u t h o r s h i p :

Hereby I declare that I have written the thesis

"Insolvency Law in the Czech Republic and in the USA"

on my own and using only the literature and sources I refer to.

Prague, August 29, 2011 Signature

Title of the Master's Thesis:

Insolvency Law in the Czech Republic and in the USA: Comparison of Reorganization Proceedings of Kordárna and General Motors Corporation

Abstract:

Insolvency law is a progressive and dynamic legal discipline closely interrelated with economics and business. A quality legal framework of insolvency is indispensable for modern market economies: it helps to identify companies or individuals in financial distress and to restructure their debts, or liquidate their assets in an efficient and transparent way. The main purpose of the insolvency law is to provide creditors and debtors with a ground for negotiations and to help them reach qualified decisions based on the available information. In the Czech Republic, the insolvency law had long been criticized for its insufficient protection of creditors and for the loopholes that made extensive property frauds possible without having the wrongdoers punished. The current Czech Insolvency Act which took effect in 2008 was broadly inspired by the U.S. Bankruptcy Code Chapter 11 and eliminated most of the weaknesses of the earlier law. This thesis shows that valuable inspiration can be found not only in texts of statutes but also in the real life. On the example of reorganizations of Kordárna and GM described here, main principles of insolvency law are being discussed.

Key words:

Insolvency, bankruptcy, reorganization, Chapter 11, Kordárna, General Motors.

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List of acronyms

- **a.s.** akciová společnost in CZ/SK – close equivalent to joint-stock company in the US or public limited company (PLC) in the UK
- **CEO** chief executive officer
- **CFO** chief financial officer
- **COIM** center of main interest
- **D/A** debt-to-assets ratio
- **D/E** debt-to-equity ratio
- **DIP** debtor-in-possession
- **EAT** earnings after tax
- **EBIT** earnings before interest and taxes
- **GM** General Motors
- **IPO** initial public offering
- **LLC** limited liability company
- **LLP** limited liability partnership
- **OECD** Organisation for Economic Co-operation and Development
- **ROA** return on assets
- **ROE** return on equity
- **S.A.** Spółka akcyjna in PL – equivalent to a.s. in CZ
- **s.r.o.** společnost s ručením omezeným in CZ/SK – close equivalent to limited liability company (LLC) in the US
- **SUV** sport utility vehicle
- **TARP** Troubled Asset Relief Program
- **USBC** United States Bankruptcy Code

Introduction

One can hardly think of two legal and business cultures where public attitude towards bankruptcy would be more different than in the Czech Republic and in the United States. While in the US, bankruptcy is understood as an inherent part of life of most businesses, and only those leaders gain true credit who have already gone through multiple bankruptcies, in the Czech business culture, bankruptcy is still viewed as a symbol of personal failure and it may seriously undermine careers of those who were involved in one. The explanation of the differing views on bankruptcy is logical, though: while the American historical experience tells local entrepreneurs that everyone has a chance to succeed and the only question is when the success will come, in the Czech society, bankruptcy remains engraved in people's memories as a criminal-like institute that enabled a few wrongdoers to strip assets from newly privatized firms in 1990s, depriving them of potential dividends or, even worse, their jobs.

Fortunately, the times are changing and so is the view of bankruptcy in the Czech Republic. In recent years, "insolvency law" has replaced the term "bankruptcy law" and insolvency itself is not strictly synonymous with liquidation any more. Since 2008, when the new Act on Insolvency and its Settlement Methods has taken effect, we have witnessed few examples of successful reorganizations of both mid-size and larger businesses where the going concern value exceeded the liquidation value and where the debtors or trustees persuaded creditors about the favorableness of a non-liquidation insolvency settlement method. The reorganization of Kordárna, a.s. is the first and most prominent of these examples. Let us hope that others will follow soon.

In contrast, the relatively stable reputation of bankruptcy in the United States has suffered a serious blow in the course of the recent economic crisis. First presented as a major success of President Obama's administration, the factual nationalization and subsequent market re-introduction of two of the three America's biggest carmakers arouse unprecedented public discussion. Discussion about the role of Government in the free market and the credibility of bankruptcy courts: many believed that they ruled according to orders from above. The reorganizations of General Motors and Chrysler have entered historical statistics among the biggest bankruptcy cases ever and now, two years after the close of the bankruptcy proceedings, some experts indicate cautious optimism concerning the future business development of the two carmakers. To be honest, who would not like to have the new electric Chevrolet Volt in his garage?

The main objective of this work is to point out the major differences between American and Czech insolvency legal frameworks, and to illustrate the benefits and pitfalls of each of them on practical examples. Although the cases of Kordárna and General Motors may seem incomparable both in terms of market capitalization of the businesses and strategic role of their operations in the national economy, several aspects will be discussed where the cases have common features. First, the core of both businesses lies in the automotive industry; second, the court proceedings in both cases were to some extent pioneering; and finally, the reorganization method selected for both Kordárna and General Motors was the sale.

The work may also serve as an introduction into the Czech insolvency law for those interested, who do not speak Czech. To the knowledge of the author, there is no complex monograph on the Czech insolvency law available in English so far, reflecting the changes introduced by the 2006 Insolvency Act. For practical purposes, a small dictionary with equivalent translations of used terms is added at the end of this work. Although the thesis does not elaborate on the subject matter in its entirety, it may give the reader a basic idea of the regulation and refer him to other sources.

Finally, this work can be used as a source of inspiration. The author is fully aware that the content balances on the edge between economics and law. In some parts, it may even deal with concepts not fully known to economists. But perhaps therefore, he would like to provoke continued discussions on the relationships between these two subjects and how they differ in theory and practice. Sadly, it seems that more and more Czech lawyers have gained practical knowledge of economics; however there are only few economists who truly understand law. Maybe, some inspiration could also come from abroad. While the comparative law has been developing dynamically over the last twenty years in the Czech Republic, the comparative economics still has many white spots that wait to be discovered.

THEORETICAL PART: COMPARISON OF THE LEGAL FRAMEWORK OF INSOLVENCY IN THE CZECH REPUBLIC AND IN THE USA

1. Legal Framework of Insolvency Proceedings in the Czech Republic

The insolvency law in the Czech Republic as we know it today is a relatively young and modern legal field. The modern epoch started after a forced 40-year discontinuity in 1989 and it was seriously marked with the typical problems of transitional economies of the 1990s. The current regulation was enacted as the Act on Insolvency and its Settlement Methods in 2006 and came into force in 2008. The first four years of its practical effect have proved that it is a working regulation that guarantees creditors in all classes sufficient rights while taking into consideration the public interest in the preservation of the going concern value of those insolvent companies where liquidation is not the only possible solution.

1.1. History of Bankruptcy Law in the Czech Republic

The history of the insolvency law within the borders of today's Czech Republic begins in the early 17th century. As a result of wars in the 16th century, and particularly the Thirty Years' War in the first half of the 17th century, many members of the lower nobility lost their mansions and an urgent need to resolve the debts of insolvent estates arose. First partial regulation of the insolvency law was embodied in the Renewed Land Ordinance, enacted in 1627.[1] In the very same year, the first documented bankruptcy of a state treasury occurred in Spain, which inspired other states to adopt complex bankruptcy rules. In the Czech lands, first comprehensive bankruptcy statute appeared in an amendment to the Renewed Land Ordinance, issued in 1640.[2] However, since the Land law was only binding for nobility, the town law, binding for the members of bourgeoisie, was lagging behind and differed in many aspects. Finally, the first universal regulation of the bankruptcy law in the Czech lands came into effect in 1781 when the Josephinian Court Regulations were enacted. [3] Nonetheless, the Regulations were still somewhat discontinuous and also the court proceedings remained very lengthy and costly.

More significant changes came in 1868 along with the Bankruptcy Order which introduced typical institutes of bankruptcy proceedings as we know it today. First and foremost, the character of the bankruptcy proceedings was changed from litigation to uncontentious

[1] ZOULÍK, F. *Vývoj insolvenčních řízení*. Právní forum, 2009, Year 6, Vol. 4, p. 155.
[2] Id.
[3] Id.

proceedings, and actions against the debtor were replaced by filing of claims. The first truly modern bankruptcy code was enacted by a Kaiser ordinance of Franz Joseph I of Austria in 1914. In was replaced once again in 1931 to align Czech and Slovak legal frameworks but the principles of bankruptcy proceedings remained mostly unchanged till the beginning of communist epoch.[4]

The forty years of communist regime constituted a serious discontinuity in the Czech private law and the bankruptcy law was not an exception. In the centrally planned economy, there was no use for it because no insolvencies could occur under the plan. Thus, the only active part of the insolvency law effective as of 1950 was the institute of executional liquidation, introducing a simplified regulation on bankruptcy proceedings. The only purpose of this vehicle, however, was to enable the Czechoslovak state and its entities to participate in bankruptcies in the capitalist countries.[5]

Shortly after the Velvet revolution, a need for a speedy reintroduction of insolvency code led to the work on a new legal framework. The legislators' efforts produced the Act on Bankruptcy and Composition which came into effect on October 1, 1991.[6] The expedited preparation along with the enactment of the new Commercial Code[7] brought about many problems which had never been fully resolved. The 1991 act ideologically followed-up to the earlier 1931 bankruptcy regulation but the paragraphs of the code were partially adopted from the 1950 communist act. Despite its weaknesses and frequent amendments, the act endured till 2008 and the number of filed bankruptcy petitions grew steadily from several hundred in 1992 to the average of 4000 in the subsequent years.[8] The changing economic reality along with the perceived weaknesses of the act, such as lengthiness of the bankruptcy proceedings and insufficient guarantees for unsecured creditors, gave rise to the legislation work on a completely new set of rules regulating the insolvency law. One of the important motives was the economic desirability to preserve those insolvent companies that have a good chance to reorganize their business and regain the viability, thus yielding their creditors higher debt satisfaction.

The main source of inspiration for the current 2006 Act on Insolvency and its Settlement Methods was the United States Bankruptcy Code and also the German Insolvency Act of

[4] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 320.
[5] ZOULÍK, F. *Vývoj insolvenčních řízení*. Právní forum, 2009, Year 6, Vol. 4, p. 155.
[6] Act on Bankruptcy and Composition, No.328, 1991.
[7] Commercial Code, No.513, 1991.
[8] ZOULÍK, F. *Vývoj insolvenčních řízení*. Právní forum, 2009, Year 6, Vol. 4, p. 155.

1994.[9] Though relatively different in essence, the two legal norms gave the legislators of the new Czech Insolvency Act an important basis for their own draft. Though not completely perfect, the new act set a solid standard for insolvency proceedings in the Czech Republic and thanks to cautiously adopted amendments, it has a good chance to last longer than its predecessor.

The new Insolvency Act also received positive feedback at the international level. In 2009, the European Bank for Reconstruction and Development issued an assessment where it deemed the Czech insolvency legal framework highly compliant with the current international standards.[10] However, it stated there was still a significant space for improvement. Especially in terms of efficiency of the insolvency proceedings, the Czech Republic was still lagging behind other OECD countries considerably. Whereby the average time of completion of the proceedings averaged 1.7 years in OECD countries in 2009, the Czech average was still 6.5 years. Similarly the costs of the proceedings relative to the value of assets and the recovery rates were much worse in the Czech Republic. The former averaged 15% in the Czech Republic compared to 8.4% in OECD and the latter averaged 20.9 cents on the dollar in the Czech Republic compared to the OECD average of 68.6 cents. The values for the United States averaged at 1.5 years, 7% of the estate and 76.7 cents on the dollar, respectively.[11]

1.2. Reasons for adopting the 2006 Insolvency Act and its key principles

As it was already noted above, the primary motive for the creation of a new insolvency legal framework was the conservative character of the 1991 Act on Bankruptcy and Composition which failed to follow the development of the economy and reflect the changing needs of business. The old act did not distinguish between debtors of different sizes and thus the large companies, where the chances for preservation of the business were much greater, often ended up at a deadlock where the only way out was an immediate sale. The act also used to be criticized for leaving the creditors in a weak position and for not providing the debtors with sufficient motivation to resolve the financial problems before reaching the state of insolvency.[12]

The authors of the 2006 Insolvency Act do not conceal their inspiration by the USBC Chapter 11 provisions, e.g. introducing the institute of debtor-in-possession, priority of debtor

[9] KUHN, P. *New Insolvency Law in Czech Republic*, Praha: White & Case LLP, 2008.
[10] World Bank, *Czech Republic: Effective Insolvency and Creditor Rights Systems*. eStandardsForum, 2010.
[11] Id.
[12] HOLEŠÍNSKÝ, P. a kol., *Nové insolvenční právo v České republice (1. část)*. Právní rádce, 22. 11. 2007

financing or the need for approval of a reorganization plan by the court.[13] An example the 1994 German Insolvency Act influence would be the creditors' protection against the reorganization of the debtor's business contrary to their interests.[14]

The key principles of the Czech Insolvency Act are incorporated directly in the statute and they should primarily serve as the basis for interpretation of other rules controlling the insolvency proceedings. According to the § 5 of the Insolvency Act, all insolvency proceedings should be bound by the following:

- Insolvency proceedings shall be effectuated in such a manner that no participant suffers any unjust harm or receives any inadmissible advantage, and that a speedy and efficient satisfaction of creditors' claims is reached, securing the highest possible recovery rate.
- Creditors granted equal priority pursuant to the Insolvency Act shall also have equal rights.
- Unless stated differently in the Insolvency Act, creditors' rights acquired in good faith before the commencement of the insolvency proceedings cannot be limited or revoked by the ruling of the insolvency court or by the procedures carried out by the trustee.
- Creditors are obligated to refrain from any actions directed towards the satisfaction of their claims out of the insolvency proceedings, if not expressly allowed to do so by the law.

1.3. Insolvency proceedings in the Czech Republic

1.3.1. Subjects participating in insolvency proceedings

The Insolvency Act defines four principal subjects that participate in each insolvency proceedings: the insolvency court, the insolvency trustee, the debtor and the creditors.

- **Insolvency court**

Insolvency court, represented primarily by the designated sole judge or a justice's clerk, executes its powers partly through its decision-making authority and partly through its supervisory authority. Insolvency proceedings as a specific kind of judicial proceedings combine elements of both the trial and execution phase of a lawsuit, i.e. the court finds the applicable law and directly executes it without having issued a final judgment. With the new

[13] KUHN, P. *New Insolvency Law in Czech Republic*, Praha: White & Case LLP, 2008.
[14] Insolvenzordnung vom 5. Oktober 1994, BGBl. I S. 2866 (German Insolvency Act), available at www.gesetze-im-internet.de/bundesrecht/inso/gesamt.pdf.

Insolvency Act, the court's authority was extended from pure determining the questions of law to assessing the economic background of the insolvency cases. Especially when deciding in reorganization proceedings, the judge has to consider the viability of the plan of reorganization or the competence of the company's management in order to meet a qualified decision. His experience and economic education can seriously affect the outcome of the whole insolvency proceedings. On the other hand, the judge has become more an observer than a moderator and it is mainly the creditors who determine the direction of the proceedings.

- **Insolvency trustee**

The main role of an insolvency trustee is to register debtor's assets and creditors' claims. In the course of the insolvency proceedings, the trustee further administers the debtor's business, oversees activities of the debtor-in-possession and reports to the creditors' committee. The trustee is nominated by the insolvency court from the list of trustees registered by the Ministry of Justice. Among the new demands on bankruptcy trustees introduced in 2008 are the requirement of university education and the imposition of material liability for unsatisfied post-insolvency claims resulting from the malpractice of the trustee.

- **Debtor**

Debtor is the central subject to each insolvency proceedings because future distribution of his assets is being determined at the court hearings. Different insolvency settlement methods are available to the debtor depending on the fact if he is a natural or legal entity, on his size and the corporative or not-for profit character of his. The new Insolvency Act motivates debtors to actively participate in the insolvency proceedings. Some practitioners believe that it should become exclusively a debtor's right to file a bankruptcy petition if he finds himself in a state of insolvency because many creditors abuse the institute of creditors' petition to collect debts out of the legal order.[15]

- **Creditors**

One of the prerequisites for declaring of the bankruptcy by the court is the plurality of creditors, therefore where the Insolvency Act speaks about a creditor, it is mostly a broader group of creditors. Creditors exert their rights through creditors' meetings and creditors' committees; in some cases the minority can be outvoted. Creditors can influence the selection of the trustee and actively participate in the reorganization proceedings if they elect not to

[15] Havel, B. *Presentation on the Czech insolvency law.* Summer school of legal interpretation, PF UK, 2010.

liquidate the debtor's assets in a straight bankruptcy. Creditors are usually being divided into classes; secured creditors can reach as much as 100% yield of the collateral realization after the deduction of administrative costs. Creditors are liable for damages caused by filing a bankruptcy petition where the conditions of insolvency were not met.

1.3.2. Definition of terms

- **Bankruptcy and insolvency**

The state of debtor's bankruptcy is a condition sine qua non for the initiation and continuation of insolvency proceedings. As defined in the § 3 of the Insolvency Act, a debtor finds himself in a state of bankruptcy if:

- He has more than one creditor,
- His financial liabilities are more than 30 days overdue,
- He is not able to meet the liabilities = he is insolvent.

The law further enumerates the presumptions of a debtor's bankruptcy, the purpose of which is to exclude creditors' filings where the creditors have not used all means available to them to recover their claims.

- **Overcapitalization and imminent bankruptcy**

The Insolvency Act speaks about insolvency also in the case of overcapitalization of debtor's assets and it defines an imminent bankruptcy. Both of these institutes should serve primarily as a preventive measure to avoid creditors' losses when the default of the debtor is highly likely.

1.3.3. Insolvency settlement methods

The former 1991 Act on Bankruptcy and Composition, as its name already suggests, knew only two methods of bankruptcy resolution: bankruptcy and composition. The institute of composition, however, turned out to be very difficult to exercise in practice and therefore the vast majority of bankruptcy proceedings ended up in the liquidation of the insolvent firms. Soon it became clear that in some cases, the liquidation of an indebted company is not the best solution and therefore the new Insolvency Act extended the scope of the settlement methods to five: straight bankruptcy, reorganization, debt discharge, petty bankruptcy and the insolvency of financial institutions.

- **Straight bankruptcy**

Straight bankruptcy, unlike the other methods, is available to all different categories of insolvent debtors. Although the desirable use of straight bankruptcy would be limited to those insolvency cases where the conditions for other settlement methods have not been met or where it would not make economic sense to consider a non-liquidation method, experts expect that straight bankruptcy will remain the predominant form of insolvency settlements. The attributes of straight bankruptcy proceedings as known from the former bankruptcy act stayed mostly unchanged and therefore it is very comfortable for practitioners to give up on the alternative methods and stick to the known. It is important to note that even an undergoing reorganization or debt-relief proceedings can be converted into a bankruptcy by the court if it finds that the conditions for their continuation are not met any longer.

The objective of the straight bankruptcy pursuant to § 244 of the Insolvency Act is the proportional satisfaction of secured creditors' claims from the yield of debtor's asset conversion into cash. Same as in the former legal regime, the straight bankruptcy is associated with liquidation of the insolvent corporation and the unsatisfied creditors' claims do not expire with the end of the proceedings.

- **Reorganization**

The primary source of the current reorganization regulations is the Chapter 11 of the 1978 U.S. Bankruptcy Code and the 1994 German Insolvency Act. Reorganization in the Czech law is principally only available to corporations with the minimum annual turnover of CZK 100 million or at least 100 employees.[16] The main purpose of reorganization is to prevent selling out assets of such companies where the going concern value is greater than the liquidation value, and thus guarantee higher satisfaction of creditors' claims. A typical candidate for reorganization would be a manufacturing company with some specific know-how, access to natural resources, registered patents, licenses or other similar assets which constitute a sustainable competitive advantage which is valuable but difficult to convert into cash.[17] A description of the institute of reorganization and its practical use is the main objective of this thesis, therefore it will be elaborated more in detail in the following chapters.

[16] § 316, art. 3, Insolvency Act, No.182, 2006.
[17] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 344.

- **Debt discharge**

Debt discharge, same as reorganization, was newly introduced to the Czech law by the 2006 Insolvency Act. It is available exclusively to non-entrepreneurial entities, both natural and legal. This means that the only alternative available to sole proprietorships and small businesses is the straight bankruptcy. The main purpose of the debt discharge, unlike the other settlement methods, is not only to secure the highest possible satisfaction for creditors but also to relief the debtors from their liabilities and to allow them to make a new start. The drafters of the Insolvency Act bore in mind the increasing indebtedness of Czech households and wanted to offer a safeguard of the last resort for those who have no chance to repay their debts in full but who still want to cooperate with their creditors and clear own name.

The Insolvency Act conditions the court approval of a debt-relief by repaying at least 30% of the debt value either from the yield of conversion of debtor's property into cash or from the yield of monthly installments, paid over the course of five years. During this time, the debtors are left with a limited income since their wage is subject to deductions forfeited to the creditors,[18] and they are also obliged to hand over the yield of any extra earnings on the debt repayment. Once the 5-year period has elapsed, the court issues a resolution that the conditions of the debt-relief were satisfied and the debtor is relieved from the remainder of his debts for good. Nevertheless, if the purpose of the proceedings is thwarted by the fault of the debtor, the court can cancel the debt-relief and convert it into straight bankruptcy proceedings.

- **Specific insolvency settlement methods**

One of the specific methods is the so called "petty bankruptcy" as defined in the § 314 of the Insolvency Act which is more or less a simplified version of straight bankruptcy available to personal entities or small businesses with a revenue smaller than CZK 2 million. The main difference from the full-size bankruptcy is a greater empowering of creditors who can decide on certain questions otherwise pertaining to the insolvency judge's competence. The obvious purpose of petty bankruptcy is to expedite the proceedings and save costs, and thus secure the creditors a higher recovery rate.

The last available insolvency settlement method is the so called insolvency of financial institutions. It will be applied in case of insolvency of a bank, insurance company or a similar financial institution. These proceedings are very similar to straight bankruptcy proceedings. However, the bankruptcy petition can only be filed by the public authority responsible for

[18] The exact calculation is specified in the § 279 of the Civil Procedure Code, No.99, 1963.

supervising activities of the insolvent institution, and special information and reporting duties are imposed on the subjects of the proceedings.

1.3.4. Initiation of insolvency proceedings

Insolvency proceedings can only be initiated based on a creditors' or debtor's filing of a bankruptcy petition. The Czech law does not give the court the authority to initiate insolvency proceedings on its own initiative. The authors of the Insolvency Act had even contemplated the cancellation of the institute of the creditors' petition; the debtor should know his own financial position better than the creditors and there were reasonable concerns about the potential abuse of the institute which were also proved valid in practice.[19] However, since the primary purpose of the Insolvency Act is to guarantee adequate protection of creditors, they retained the right to file a bankruptcy petition. On the other hand, the law obliges the debtors to file a petition for their own bankruptcy if they find themselves in a state of insolvency; otherwise they are subject to financial liability for resulting damages.[20] The debtor, unlike creditors, can also file the claim in case of an imminent bankruptcy if there is a reasonable cause to believe that he will not be able to repay a substantial part of his liabilities.[21] The initiation of insolvency proceedings is never coincident with the court's declaration of bankruptcy; the court always examines if the conditions of a bankruptcy have been met.

The initiation of insolvency proceedings is announced by a public notice which shall be published in the Insolvency register within two hours from the receipt of a bankruptcy petition. The court also has to inform public authorities about newly the initiated insolvency proceedings in order to give them a chance to register their claims against the debtor. Moreover, firms in insolvency are excluded from public tenders.

- **Bankruptcy petition**

Each bankruptcy petition has to contain essential requisites including the identification of the petitioner and the debtor, key facts documenting the debtor's insolvency and the demand on the court to declare bankruptcy.[22] In case of a creditors' petition, the creditor has to prove his right to file the petition, i.e. that he has a valid claim against the debtor and that the claim is overdue. Simultaneously, he has to register his claim. In case of a debtor's petition, the list of assets, employees and liabilities are an obligatory part of the filing. The petitioner can also

[19] HAVEL, B. *Insolvenční návrh a zneužití práva*. Moderní řízení, 27. 8. 2010.
[20] § 98 and 99, Insolvency Act, No. 182, 2006.
[21] § 97, art. 3, Insolvency Act, No. 182, 2006.
[22] § 103, Insolvency Act, No. 182, 2006.

attach a motion for approval of reorganization (or debt-relief) to his petition. If the petition contains defects in its essential requisites, the court has to dismiss such a filing.

- **Automatic effects following the initiation of insolvency proceedings**

The initiation of insolvency proceedings constitutes several consequences which take effect at the moment of publication of the court's notice in the Insolvency register. The main purpose of this measure is to prevent both the debtor and the creditors from circumventing the order of priority according to which the creditors are being satisfied at a later stage. The established legal constraints limit both the property rights related to the assets of the debtor and also the rights of the creditors related to the satisfaction of their claims against the debtor. With the initiation of insolvency proceedings, the assets of the debtor are protected from the execution and the court can nominate a preliminary insolvency trustee who registers the debtor's assets.

- **Temporary stay**

One of the institutes newly borrowed from the USBC Chapter 11 is the so called temporary stay. The purpose of the stay is to give the debtor a temporary immunity against the creditors' claims and thus enable him to avert the declaration of bankruptcy and secure the continued business operations by repaying the debts to direct suppliers preferentially. The stay is only available to corporations and the court decides on the approval of the stay based on the debtor's petition. The duration of an approved stay is limited to 120 days[23] during which the court cannot declare the bankruptcy of the debtor. The secondary purpose of the stay is to protect the debtor from abusive acts of the creditors[24] and vice versa, i.e. from the damage caused to a creditor, which may result in the criminal prosecution.[25]

1.3.5. Declaration of bankruptcy and decision on the settlement method

The insolvency court is obliged to try every bankruptcy petition unless any reasons for a dismissal of the petition were given or unless the petitioner withdrew his filing. The court primarily examines if the legal reasons for the declaration of bankruptcy are given and if the facts stated in the petition for bankruptcy and its appendices are truthful. The insolvency judge usually orders a court hearing only in case of creditors' petitions. The Insolvency Act established relatively short time limits for the proceedings: the court has to take actions heading to the decision on merits within ten days of the petition filing, were the facts in the

[23] § 119, art. 1 and 2, Insolvency Act, No. 182, 2006.
[24] Creditors' liability for such a harmful conduct is established by the § 147 of the Insolvency Act.
[25] Damage to a creditor or advantaging to a particular creditor are criminal offences according to the § 222 and § 223 of the Criminal Code, No.40, 2009.

petition taken as proved without further investigation, the final decision has to be issued within fifteen days.[26]

Once it was established that a debtor finds himself in a state of bankruptcy, the court issues the bankruptcy declaration where it nominates an insolvency trustee and invites creditors to register their claims against the debtor. The claims may be registered within a specified period not shorter than thirty days and longer than two months. The court also convenes a creditors' meeting and selects the news media where the court's decisions will be published.[27]

In case of an issued bankruptcy declaration based on a creditors' petition, the debtor's appeal is admissible if it is directed against the bankruptcy declaration itself or if stating that an estoppel to the proceedings was established.

The Insolvency Act enumerates several reasons for a dismissal of a petition for bankruptcy. Besides the obvious reason that the legal conditions for declaring the bankruptcy were not met (multitude of creditors, overdue liabilities, insolvency of the debtor), the court may also dismiss a petition due to lack of debtor's property (such insolvency proceedings would be clearly useless)[28] or due to an illegal conduct of a third party that caused the debtor's insolvency.[29] An unsuccessful petitioner may appeal against the court's dismissal of bankruptcy petition.[30]

When possible, the court issues decision on the insolvency settlement method jointly with the bankruptcy declaration. In those cases where the Insolvency Act does not allow a different settlement method than straight bankruptcy (sole proprietorships and small businesses with annual revenue below CZK 100 million), the court automatically decides for the bankruptcy (or petty bankruptcy).[31]

Otherwise, if there was a motion for reorganization approval filed along with a plan of reorganization, accepted by at least one half of both secured and unsecured creditors, the court simultaneously decides on this motion. Similar procedure applies by motions for debt-relief

[26] § 134, Insolvency Act, No. 182, 2006.
[27] § 136, art. 2, Insolvency Act, No. 182, 2006.
[28] Conditions given in the § 144, Insolvency Act, No. 182, 2006.
[29] § 143, art. 3, Insolvency Act, No. 182, 2006.
[30] § 145, art. 2, Insolvency Act, No. 182, 2006.
[31] § 148, art. 1, Insolvency Act, No. 182, 2006.

approval.[32] If the conditions for the decision on the settlement method are not met, the court decides in a separate ruling based on the resolution accepted in the creditors' meeting.[33]

The creditors' meeting convened by the court decides on the acceptance of the insolvency settlement method in a vote by a qualified majority of at least one half of unsecured and one half of secured creditors counted by the amount of their liabilities, alternatively by the majority of 90% of all present creditors.[34]

1.3.6. Satisfaction of creditors' claims

The necessary condition for the satisfaction of creditors' claims besides the existence of such a claim against the debtor is also its registration at the insolvency court. Registrations of the claims are possible from the initiation of the insolvency proceedings till the end of the period determined by the court in the bankruptcy declaration. The claims can only be specified in money, secured creditors have to indicate that they claim the right for the satisfaction from the collateral and specify the character of the collateral.

Registered claims are first being examined by the insolvency trustee. Subsequently, the court calls a review hearing where the claims marked by the insolvency trustee are being tried and can be denied either by the trustee or by the debtor. Creditors who register significantly overvalued claims or securities can be sanctioned for such actions.[35]

Creditors' claims are satisfied from the property of the debtor which includes all of the debtor assets, claims, rights or other asset values appreciable in cash.[36] In case of debtor's bankruptcy petition, the property includes all assets the debtor owned on the day of the initiation of the insolvency proceedings or gained during the proceedings. In case of creditors' claims, the property is being determined on three different occasions during the insolvency proceedings.[37]

1.3.7. Straight bankruptcy

The purpose of this work, among others, is to compare the advantages and disadvantages of different insolvency settlement methods available to business corporations in the Czech Republic and in the United States. The following two chapters will closer examine two central

[32] § 148, art. 2 and 3, Insolvency Act, No. 182, 2006.
[33] § 149, art. 1, Insolvency Act, No. 182, 2006.
[34] § 151, art. 1, Insolvency Act, No. 182, 2006.
[35] § 178 – 180, Insolvency Act, No. 182, 2006.
[36] § 206, Insolvency Act, No. 182, 2006.
[37] § 205, art. 2, Insolvency Act, No. 182, 2006.

settlement methods used in the Czech Republic. First of those two, the straight bankruptcy, is a well-known institute that has been present in the Czech legislature for almost 100 years now.[38]

The key purpose of straight bankruptcy is to realize the value of debtor's property through the sale of his assets to third parties and then proportionally satisfy the creditors' claims from the yield of this sale; the unsatisfied or party unsatisfied claims do not expire. The objective is to maximize this yield. An important question to ask is if the straight bankruptcy will always be the most efficient tool. One of the acknowledged benefits of the 2006 Insolvency Act is that it introduced a new non-liquidation insolvency settlement method into the Czech law and thus enabled the preservation of positive going concern value of insolvent corporations. However, as Tomáš Richter notes in his work (Richter, 2008, p. 349), although bankruptcy is a liquidation method of insolvency settlement it does not automatically mean that the activities of the debtor have to be terminated in it; the company may be still sold as a whole.[39] In the end, some of the reorganized companies will be sold too as will be described further in this work.[40]

Thanks to its relative simplicity and availability to all debtors, straight bankruptcy is by far the most frequently used insolvency settlement method. The number of declared bankruptcies of corporations amounts to several hundred each months. In contrast to straight bankruptcies, approved reorganizations can be counted on the fingers of one hand, as shown in the Table 1.

Table 1: Overview of undergoing insolvency proceedings, January – August 2010

	Filed bankruptcy petitions	Declared bankruptcies	Declared straight bankruptcies	Approved debt-reliefs	Approved reorganizations
January	824	462	183	285	1
February	1,085	436	186	255	0
March	1,433	643	195	435	2
April	1,290	614	202	421	4
May	1,335	592	214	411	1
June	1,378	525	192	344	4
July	1,254	527	206	352	2
August	1,303	615	251	397	1

Source: Czech Bar Association

[38] First enacted by the 1914 Kaiser Franz Josef I ordinance, slightly changed in the Czechoslovak Bankruptcy Act of 1931 and then brought back after a period of discontinuity by the 1991 Act on Bankruptcy and Composition, the current regulation still builds on the same basic principles.
[39] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 343.
[40] Sale within the reorganization proceedings is the common attribute of both the reorganization of Kordárna and General Motors as discussed in the practical part of this work.

- **Declaration of straight bankruptcy**

Straight bankruptcy is declared by a decision of the insolvency court which can be joined to the declaration of debtor's bankruptcy in cases where the Insolvency Act does not offer any other settlement method. Another possible ground for the initiation of a straight bankruptcy, however rare, is the conversion from reorganization.[41] The effects of the declaration come into force with its publication in the Insolvency register: First, an undergoing liquidation of the debtor is suspended, a forced administration is terminated and any previously ordered preliminary measures expire.[42] Second, the disposition rights to the debtor's property are transferred to the insolvency trustee and similarly the rights and duties related to the property are newly exercised by the trustee. This basically means that the debtor's management is relieved of their decision-making powers but not that the production in debtor's enterprise has to be ceased. Third, the creditors can only exercise their claims by registering them in the straight bankruptcy proceedings. Fourth, the so far undue debts convert into mature. Fifth, unless the trustee confirms their performance within fifteen days, contracts on mutual fulfillment are considered recalled.[43]

- **Conversion of property into cash**

The conversion of the debtor's property into cash funds can only be initiated after the legal power of the straight bankruptcy declaration and once the first creditors' meeting has gathered. The reason for these limitations is interest in the protection of the debtor from the consequences of such a conversion in the event of a revision of the first decision. Since the trustee decides on the conversion method based on the creditors' committee approval, the creditor's meeting has to precede such an approval.[44]

Specific rule applies when a realty used by the debtor as a dwelling of his own or his family is sold in the proceedings. The debtor has the duty clear out the realty, which can be enforced by the court. Nevertheless, the debtor can claim a compensation for loss of his housing in the form of a shelter.[45]

A divergent regulation affects the procedure of conversion in case of registered secured claims. Secured creditors can give the insolvency trustee express directions concerning the

[41] § 363, Insolvency Act.
[42] § 245, art. 2, Insolvency Act, No. 182, 2006.
[43] § 253, art. 2, Insolvency Act, No. 182, 2006.
[44] § 286, art. 2, Insolvency Act, No. 182, 2006.
[45] § 285, art. 3, Insolvency Act, No. 182, 2006.

conversion of the collateral which are binding for the trustee but may be revised by the court.[46]

The Insolvency Act enumerates three possible ways how the property can be converted into cash:

- **Public auction pursuant to the Act on Public Auctions**
  Public auction is best suitable for the sale of commodities or realties where it is relatively easy for the potential buyer to obtain sufficient amount of information. More complex assets such as a going concern will thus be only rarely sold in a public auction.[47]
- **Sale of chattels and realties pursuant to the Civil Procedure Act execution rules**
  Sale pursuant to the Civil Procedure Act execution rules is carried out in an auction too,[48] typically in the cases where the property is of a lesser total value.
- **Sale outside of auction**
  The third method of conversion is the sale outside of auction which is a typical form of sale of a going concern. The insolvency trustee can only realize such a sale if it was previously approved by the court and the creditors' committee.[49] The court also determines if the sale will be carried out by the means of a private or public tender. Going concerns or more complex assets are usually being converted in an auction sale. As it was already mentioned before, straight bankruptcy allows for the sale of a corporation as a whole, i.e. through a single contract.[50] The rights and obligations arising from labor contracts with the debtor's employees automatically pass to the buyer who also has to secure all licenses required for continued operations of the business.[51]

- **Satisfaction of creditors' claims**

Creditors' claims against the debtor and the costs related to the administration of the property are satisfied from the yield of the conversion. Secured creditors are entitled to the satisfaction

[46] §293, Insolvency Act, No. 182, 2006.
[47] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 365.
[48] § 328b and § 336b of the Civil Procedure Act, No.99, 1963.
[49] § 289, art. 1, Insolvency Act, No. 182, 2006.
[50] § 290, Insolvency Act, No. 182, 2006.
[51] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 366.

from the yield of the collateral conversion from which the costs of the conversion, costs of its administration and trustee's remuneration are deducted.[52]

Besides the secured claims, there are also other claims which have to be satisfied prior to the schedule – the claims related to the property, which arise after the initiation of the insolvency proceedings, and claims considered equal to them.[53] In case the yield of the conversion cannot satisfy all of these claims, the Insolvency Act determines the order according to which the claims will be satisfied.[54]

At the end of the straight bankruptcy proceedings, the insolvency trustee compiles the final report where he specifies details of all claims, information on the assets, their conversion and the proposed distribution of the yield to the yet unsatisfied creditors. Along with the final report, the trustee submits the financial statement and the statement of his own costs.[55] After the final approval of the report by the court, the schedule of claim satisfaction is approved and the claims are paid off within two months by the trustee.[56]

1.3.8. Reorganization

Reorganization, unlike straight bankruptcy, is not a strictly regularized insolvency settlement method. The essence of reorganization is an agreement between creditors on how to resolve the crisis to achieve a higher recovery rate than in a usual straight bankruptcy case. The Insolvency Act constitutes two criteria the purpose of which is to filter out those firms where the chance of successful reorganization does not outweigh the potential risks: first, the court may only approve reorganization of such a company that achieved an annual turnover of at least CZK 100 million in the last fiscal period or had at least 100 employees;[57] second, the court has to dismiss the reorganization where the plan of reorganization submitted by creditors was not approved in the creditors' meeting.[58] These safeguards should prevent economically inefficient reorganizations where the individual motivation of participating subjects may lead to a socially undesirable outcome.

The regulation of reorganization pursuant to the 2006 Insolvency Act is based on the 1978 USBC Chapter 11; it was also partly influenced by the German and Austrian insolvency regulations. The principle of reorganization is to preserve the going concern value of an

[52] § 298, art. 3 of the Insolvency Act limits the costs of conversion to 5 % and the costs of the asset administration to 4 % of their yield, unless otherwise agreed with the secured creditor.
[53] § 168 and § 169, Insolvency Act, No. 182, 2006.
[54] § 305, art. 2, Insolvency Act, No. 182, 2006.
[55] § 302 and § 303, Insolvency Act, No. 182, 2006.
[56] § 306 and § 307, Insolvency Act, No. 182, 2006.
[57] § 316, art. 4, Insolvency Act, No. 182, 2006.
[58] § 326, art. 1, Insolvency Act, No. 182, 2006.

insolvent corporation, rationalize or restructure the internal processes in order to bring the corporation back to profitability and then satisfy the creditors' claims from the yield of continued operations. Alternatively, a reorganized firm can be sold to a strategic investor and the creditors be repaid from the yield of this sale; that was also the case of the two companies examined in this work.

Reorganization can only be efficient if two basic conditions are met:[59]

- **The insolvent corporation has a positive "going concern value"**
  Going concern value is the value of a firm with running operations. A positive going concern value is present where the value of the corporation as a whole exceeds the value of its single assets if sold separately. The positive value is usually represented by a specific combination of assets exploited by the corporation, know-how of its employees, strategic factors which bring sustained competitive advantage such as registered patents or unique technologies, or other soft factors, no matter if the value of these factors can or cannot be valued in cash. In other words, a corporation with a positive going concern value should be capable of generating profits in the long term if administered rightly.
- **This value cannot be realized through a sale on acceptable transaction costs**
  The transaction costs constitute the main obstacle to the distribution of production factors among those who can best realize their value. According to the Coase theorem, if the transaction costs were zero, the exchange should eliminate inefficient use of economic resources. Thus, if the production factors used by the insolvent company have a positive value, there must be someone else in the market who could generate profits by employing them; they should never remain unused. However, the transaction costs often exceed the potential contribution of the resources and then they remain idle.

  In this case, we speak about the sale of an insolvent company with the aim to continue its operations. It seems logical that if there is a positive going concern value, the transaction costs of a simple sale should not exceed this value. Unfortunately, the insolvency proceedings are in principle very costly and therefore, the sum of these costs may easily consume all the remaining positive value.

[59] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 343 – 344.

According to the definition in the Insolvency Act,[60] reorganization is a process of gradual satisfaction of creditors' claims while the operations of the insolvent corporation are maintained and measures taken to ensure the strengthening of the business of the firm pursuant to the approved plan of reorganization. Creditors should control the observation of the plan.

Among all insolvency settlement methods, reorganization gives creditors the greatest powers to control the evolvement of insolvency proceedings. The insolvency court and trustee play mainly the control role and guarantee the lawfulness of creditors' actions. The success of reorganization is strongly dependent on the ability of the creditors to come to a mutual agreement concerning the plan of reorganization. The less the court has to intervene in the process, the better. Although the negotiations of creditors and the debtor may bring about additional costs, the creditors should be motivated to reach a mutually beneficial solution. The law gives them a broad range of tools how to do that.

- **Motion for approval of reorganization**

The key factor determining if reorganization will be successful is the moment of reaching an agreement on the plan of reorganization. This can happen at two different stages of the insolvency proceedings. The first comes into play if the creditors agree on effectuating reorganization in the initial stage of the insolvency proceedings or even before the insolvency proceedings start, and if they also agree on the plan of reorganization. Only then they can file the motion for the approval of reorganization along with the bankruptcy petition. This institute is called pre-packaged reorganization.[61] In such a case, if the plan of reorganization is approved by the court, the insolvency proceedings will be significantly shorter and a better chance exists that the going concern value will be preserved. However, in the more likely second scenario, the negotiations on the plan of reorganization will only start after the approval of reorganization by the court which can cause a significant delay and bring about additional costs.

The active legitimacy to file a motion for approval of reorganization is given to the debtor and every registered creditor if he acts in a good faith concerning the fulfillment of the conditions of reorganization.[62] The motion must be filed no later than ten days before the day of the first

[60] § 316, art. 1, Insolvency Act, No. 182, 2006.
[61] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 380.
[62] § 317, art. 1, Insolvency Act, No. 182, 2006.

creditors' meeting, following the declaration of bankruptcy, in case of debtor's motion no later than bankruptcy is declared by the court.[63]

The motion has to contain the following requisites:

- Identification of the debtor
- Information about the way of proposed reorganization

In case of debtor's motion, the law requires also the information on the capital structure and property of controlling entities that form a concern with the debtor. Creditors' motion must be approved in the creditors' meeting before filing to the court.

- **Approval of reorganization by the court**

In its decision on the approval of the proposed reorganization, the court is bound by the resolution of the creditors' meeting. Therefore, if the meeting has voted on the reorganization method of insolvency settlement, the court can only dismiss the motion if one of the following conditions is established:

- There is a good cause to believe that the motion pursues a deceitful intention.
- The motion was filed repeatedly by the same person in the same insolvency proceedings despite its prior dismissal.
- In case of the creditors' motion, the approval of the creditors' meeting was not given.

If the conditions for the dismissal are not given, the court issues a resolution on the approval of the reorganization.[64] An appeal against such ruling is not admissible.

The law associates several effects with the approval of reorganization: the existing disposition constraints on the debtor's assets expire unless otherwise ruled by the court.[65] Nevertheless, dispositive actions of substantial importance require a preceding approval of the creditors' committee.[66] Actions of the debtor are also subject to the supervision of the insolvency trustee.[67] The position of the debtor is similar to the position of the debtor-in-position pursuant to the USBC Chapter 11 regulation. Another important effect of the reorganization

[63] § 318, Insolvency Act, No. 182, 2006.
[64] § 328, Insolvency Act, No. 182, 2006.
[65] § 332, Insolvency Act, No. 182, 2006.
[66] § 330, art. 3, Insolvency Act, No. 182, 2006.
[67] § 331, Insolvency Act, No. 182, 2006.

approval is the transfer of part of the competencies from the debtor's general meeting to the insolvency trustee and to the creditors' committee.[68]

- **Plan of reorganization**

Plan of reorganization is a governing document regulating the process of reorganization, which is binding for the debtor after the court approval and the nonobservance of which may lead to the conversion of the reorganization into straight bankruptcy in an extreme scenario. The purpose of the reorganization plan is to determine the rights and duties of the entities participating in the reorganization, following the measures directed to the stabilization of the debtor's business and to the settlement of mutual relationships between the debtor and his creditors.[69] Therefore, the plan of reorganization must be truthful and achievable.[70] Reorganization plan is subject to the court approval after which the existing liabilities of the debtor expire and simultaneously, new liabilities arise, guaranteeing satisfaction of creditors' claims from the yield of the continued business operations.

The law constitutes several requisites to the plan of reorganization:[71]

- Division of creditors into classes, specifying how their claims will be treated
- Determination of the method of reorganization
- Determination of measures directed to the fulfillment of the plan including the persons with the disposition rights to the property
- Information on the conditions of further operation of the debtor's business
- Specification of the persons who will provide the funding for the reorganization plan or who will take over the debtor's liabilities
- Information on the impacts of the reorganization on the debtor's employees
- Information on the debtor's liabilities to the creditors after the completion of the reorganization
- Information on the securing of satisfaction of those liabilities that will only be determined at a later stage

The Insolvency Act enumerates potential measures for the reorganization that may be listed in the plan of reorganization:[72]

[68] § 333, Insolvency Act, No. 182, 2006.
[69] § 338, Insolvency Act, No. 182, 2006.
[70] § 340, art. 3, Insolvency Act, No. 182, 2006.
[71] § 340, Insolvency Act, No. 182, 2006.

- Restructuring of a part of the creditors' claims through a debt-relief or a deferment of payments
- Sale of the debtor's property or its part, or sale of the debtor's business
- Transfer of a part of debtor's assets to the creditors or to a new entity
- Merger of the debtor with the preservation of the third party rights
- Emission of shares of the newly created entities
- Securing of continued funding of debtor's business operations
- Amendments to the debtor's foundation charter newly defining internal organization of the debtor's business

The specific method of reorganization depends primarily on the agreement between the debtor and creditors, only such actions are prohibited that contravene or circumvent the law, or which pursue a deceitful intention.

- **Legitimacy for the drafting of the plan of reorganization**

The priority to draft a plan of reorganization is given to the debtor. Although the preference of the debtor contrasts with the claimed protection of creditors, the legislator proceeds from the presumption that the debtor has better information on his business and thereby motivates him to take a faster action. The debtor can either submit his reorganization plan along with the motion for the approval of reorganization (which, in turn, can be filed along with the bankruptcy petition) or within 120 days thereafter. The deadline can be extended once by another 120 days if the court finds that the case is too complex.[73]

Nevertheless, creditors can deprive the debtor of the right to draft the plan of reorganization and nominate a person who will create the plan instead. Same rule applies if the debtor gives up his right.[74] The judge can also deprive the debtor of this right if he finds that the debtor does not work on the plan; then he nominates a person who will create the plan instead.

Along with the plan of reorganization, the drafter of the plan of reorganization creates a report on the plan of reorganization which serves as a kind of executive summary for the creditors which will help them to make a qualified decision on the acceptance or non-acceptance of the

[72] § 341, art. 1, Insolvency Act, No. 182, 2006.
[73] § 339, art. 1, Insolvency Act, No. 182, 2006.
[74] § 339, Insolvency Act, No. 182, 2006.

plan. In the report, the drafter can also explain his decision on the division of the creditors into classes which may have a significant influence on the subsequent creditors' vote on the plan.[75]

- **Approval of the plan of reorganization**

The approval of the plan is carried out in two phases. First, the creditors vote on the acceptance of the plan in the creditors' meeting, each class votes separately. The plan is accepted by the particular class if at least one half of the creditors within the class measured by the size of their claims and a simple majority of the voting creditors agree. If one creditor has more claims in several classes, he votes separately in each class. Creditors whose claims are unaffected by the plan are presumed to have given the approval.[76]

Second, the court has to approve the plan accepted by the creditors. If all of the creditors' classes accepted the plan, the court will give the approval automatically unless the plan is contrary to the law, deceitful or unless it guarantees the creditors a lower satisfaction than they would receive in a straight bankruptcy; otherwise the court will dismiss the plan. The court may also approve a plan accepted by at least one creditors' class if the equality, feasibility and fairness conditions are met. [77] An appeal against the court's approval is admissible, the active legitimacy belongs to those creditors who voted against the plan of reorganization.[78]

- **Execution of the plan of reorganization**

Once the plan of reorganization has been approved by the court and comes into force, the following effects ensue:

- The disposition rights related to the property belong to the debtor and other constraints originated during the insolvency proceedings expire
- The powers of the general meeting forfeited to the insolvency trustee are restored
- Pursuant to the plan of reorganization, the modifications to the foundation charter come into effect, the changes are registered in the Insolvency register[79]
- Creditors' claims against the debtor expire and new originate as determined by the plan of reorganization[80]

[75] § 337, art. 1, Insolvency Act, No. 182, 2006.
[76] § 347, Insolvency Act, No. 182, 2006.
[77] § 348, Insolvency Act, No. 182, 2006.
[78] § 350, art. 1, Insolvency Act, No. 182, 2006.
[79] § 353, Insolvency Act, No. 182, 2006.
[80] § 356, art. 1, Insolvency Act, No. 182, 2006.

The debtor-in-possession who executes the plan of reorganization is subject to supervision of the insolvency trustee, the debtor is obligated to report on the fulfillment of the plan and other important actions, the trustee in turn reports to the court and to the creditors' committee.[81]

- **End of the reorganization**

There are three possible outcomes of reorganization proceedings:

- **Cancellation of the approved plan of reorganization**

  The court will cancel an approved plan within six months of its force if it turns out that some creditors were advantaged without a cause or if the approval was reached by a fraud.

  The court will also cancel the plan if a debtor or a statutory body of his was convicted of a criminal act which led to a wrongful approval of the plan or to the curtailment of creditor's rights.[82]

- **Conversion of the reorganization into straight bankruptcy**

  The insolvency court converts the reorganization into straight bankruptcy if the reorganization plan has not been fulfilled in its principal points and if at least one of the following conditions were met:[83]

  - The debtor proposed the conversion of reorganization approved previously based on his own motion.
  - The authorized person does not complete the plan of reorganization till the deadline.
  - The insolvency court did not approve the plan and the deadline for its completion has passed.
  - The debtor does not fulfill his duties established by the plan.
  - The debtor does not pay interests pertaining to the claim of a secured creditor[84]
  - The debtor terminated his business activities in contradiction to the plan.

- **Accomplishment of the plan of reorganization**

  Once the plan in its entirety or in its principal points has been fulfilled,[85] the court acknowledges its accomplishment and confirms the termination of the reorganization proceedings by a resolution.

[81] § 354, Insolvency Act, No. 182, 2006.
[82] § 362, Insolvency Act, No. 182, 2006.
[83] § 363, Insolvency Act, No. 182, 2006.
[84] § 171, art. 4, Insolvency Act, No. 182, 2006.

1.4. Conclusions on the Czech insolvency regulation

The Act on Insolvency and its Settlement Methods was adopted in 2006 and came into force on January 1, 2008. Over the nearly four years of its effect, the act was twelve times amended (and four times during the "vacation legis" period) and twice affected by decisions of the Constitutional Court. The number and pace of these changes prove that the new regulation is developing dynamically and that there is an urgent need to reflect the practical experience in the text of the statute.

Nevertheless, the steadily growing number of bankruptcy petitions filed at the courts show that both individuals and corporations quickly learned how to use the new institutes introduced by the Insolvency Act and many positive reviews of the practitioners and non-governmental organizations prove that the enactment of the act was an important and beneficial step for the Czech economy. In contrast to the high figures in the tables below, only 51 reorganizations have been approved by the courts so far, 16 of which were converted into straight bankruptcies and only 5 successfully closed by accomplishing the plan of reorganization.

Table 2: Filed petitions for bankruptcy, 2008 - 2011

Filed bankruptcy petitions (including repeated petitions)												
	2008			2009			2010			2011		
Mon.	Total	Corp.	Ind.	Total	Corp.	Ind.	Total	Corp.	Ind.	Total	Corp.	Ind.
1	273	106	167	441	296	145	819	348	471	1439	429	1010
2	495	205	290	594	368	226	1084	424	660	1813	529	1284
3	487	265	222	678	427	251	1436	523	913	2169	615	1554
4	497	285	212	723	465	258	1291	456	835	1789	490	1299
5	390	261	129	694	402	292	1338	444	894	2084	561	1523
6	409	271	138	891	507	384	1376	471	905	2146	573	1573
7	418	285	133	863	490	373	1257	373	884	1769	496	1273
8	436	328	108	824	426	398	1307	468	839			
9	471	343	128	883	444	439	1347	432	915			
10	465	322	143	867	465	402	1490	472	1018			
11	488	341	147	994	464	530	1669	542	1127			
12	525	406	119	1040	501	539	1704	606	1098			
Total	**5354**	**3418**	**1936**	**9492**	**5255**	**4237**	**16118**	**5559**	**10559**	**13209**	**3693**	**9516**

Source: Creditreform, 2011

Table 3: Filed petitions for bankruptcy measured by the number of debtors, 2008 - 2011

	2008 Jan - Dec			2009 Jan - Dec			2010 Jan - Dec			2011 Jan - Jul		
	Total	Corp.	Ind.	Total	Corp.	Ind.	Total	Corp.	Ind.	Total	Corp.	Ind.
Debtors	**4600**	**2913**	**1687**	**8394**	**4570**	**3824**	**13919**	**4852**	**9066**	**12201**	**3417**	**8784**

Source: Creditreform, 2011

[85] § 364, art. 2, Insolvency Act, No. 182, 2006.

Table 4: Declared straight bankruptcies of businesses, 2008 - 2011

Declared straight bankruptcies of businesses					
Month	**2008**	**2009**	**2010**	**2011**	**Out of that sole proprietorships***
1	6	106	133	144	42
2	31	110	142	140	34
3	89	140	158	173	36
4	141	146	137	143	35
5	119	130	132	171	38
6	65	114	149	155	39
7	75	148	121	113	31
8	66	121	123		
9	91	143	121		
10	101	138	117		
11	108	129	146		
12	85	128	122		
Total	**977**	**1553**	**1601**	**1099**	**255**

Source: Creditreform, 2011

According to the Minister of Justice, Jiří Pospíšil, soon after the completion of undergoing analysis on the insolvency proceedings and experience with its application, a new, extensive conceptual amendment to the Insolvency Act will be introduced before Government and Parliament. If the experts and legislators find a common ground, the proposed changes could come into effect in 2013.[86]

Below, there is a short overview of the most important changes made to the Insolvency Act since its adoption in 2006.

- **Changes to the Insolvency Act reflecting the economic crisis:**[87]

The first group describes the amendments which the Government and experts proposed in response to the adverse effects of the financial crisis started in 2008 and the subsequent rapid growth of filed bankruptcy petitions. The main purpose of these changes was to help those businesses harmed by the crisis to maintain their operations and thus prevent the growth of unemployment.

- **Leaving out the debtor's duty to file a bankruptcy petition for his own in the event of overindebtedness:** the purpose of this change is to give the debtor a chance to overcome the crisis in a different way unless the situation of his business meets the criteria of insolvency as defined by the act.

[86] POSPÍŠIL, J. *Insolvenční zákon proti šikaně*. Ekonom, 27. 1. 2011.
[87] ZÁLUSKÝ, J. *Insolvence bude firmy méně bolet.* Hospodářské noviny, 18. 6. 2009.

- **Leaving out the institute of unilateral claim setoff in case reorganization proceedings have been initiated:** because creditors' claims automatically become due with the declaration of bankruptcy, the unilateral setoff can do the business in crisis out of the cash, which is necessary to maintain operations.
- **Creditors financing the reorganization equalized to secured creditors:** secured creditors, typically banks, are usually reluctant to finance the reorganization because it does not bring them any benefit compared to straight bankruptcy. Therefore, if there is someone willing to provide the credit financing, he should get a sufficient collateral. Nevertheless, if the existing secured creditors come with the same or better offer than any new potential creditor, they are given priority.
- **Stronger protection of debtor's employees:** Government pays out grants in the event of employer's bankruptcy already during the period of temporary stay

- **Technical changes:**[88]

Other changes are mostly of a technical character and they were necessitated by loopholes discovered in the Insolvency Act or by practical experience with misinterpretation or abuse of some of the institutes and instruments of the Insolvency Act.

- **Authority of the court to dismiss an ungrounded bankruptcy petition:** effective next year, the court should examine not only if a bankruptcy petition is formally perfect but also if the petition has a reasonable ground, otherwise it will be dismissed within a week of the filing and the petitioner will be fined.
- **Petitioner will have to give a security along with filing a bankruptcy petition:** if the petition will be dismissed at a later stage, the security will be used to cover the potential damages caused to the debtor
- **Extension of the two hour limit for the publication of initiated insolvency proceedings:** if the petition is delivered to the court out of its office hours, the information will be published on the next working day

Clearly, the Insolvency Act still has its weak points that cannot be eliminated easily by amendments. Therefore, new ways should be found how to use the law in order to reach the desired results. Similarly, the courts should provide binding interpretation where the meaning of the law is ambiguous.

[88] HROZA, J. *Kdy skonční věřitelská šikana.* Ekonom, 30. 6. 2011.

2. Legal Framework of Insolvency Proceedings in the United States

The 1978 United States Bankruptcy Code (USBC) and its Title 11 are considered one of the most complex bankruptcy regulations in the world. No wonder that many legislators from other countries openly admit their inspiration by the American bankruptcy law. But where did the USBC itself come from? True, bankruptcy law in the United States has a long tradition that dates from the times of big railway bankruptcies at the end of 19th century. However, the true origin of the USBC could be found on the British Isles. Bound together by the Common law tradition, the English and American legal systems had long developed hand in hand and have many similarities till nowadays. Yet, they differ substantially from the Civil law as we know it from continental Europe.

It is often said that the modern business has no bounds any more, and along with the fall of trade barriers, the law of commerce becomes more and more alike all around the world. But that is still not fully right; otherwise we would have probably drawn inspiration from the UK bankruptcy law instead. American law students often ask their professors which of the two Common law systems is better and who does copy from whom. A typical answer usually follows: "Of course our law is better because we borrow what is good from the English law and upgrade it to a higher level." At the beginning of the last decade, Czech legislators tried out a similar experiment. They took over the US bankruptcy regulations and attempted to customize it to the Czech law. Which of the two regulations suits better the business needs, you may judge yourself.

2.1. History of bankruptcy law in the United States

The early history of the US bankruptcy law started with the United States Constitution in 1789 which gave the Congress the authority to legislate for bankruptcy laws. First law regulating bankruptcies came eleven years later, in 1800, but it only applied for a limited circle of debtors. After the 1841 and 1867 Acts on Bankruptcy, the first complex modern Bankruptcy Act came in 1898, also known as the Nelson Act. Forty years later, the 1938 Chandler Act followed, which introduced the modern concept of debtors' bankruptcy petitions and entrusted the Securities and Exchange Commission with the oversight and administration of bankruptcy filings. Finally, another forty years later, the current 1978 Bankruptcy Code followed, officially called The Bankruptcy Reform Act of 1978.[89]

[89] BROUDE, R. *Reorganizations Under Chapter 11 of the Bankruptcy Code.* NY: ALM Publishing, 1986, P. 1-9.

2.2.1978 United States Bankruptcy Code and its background

The 1978 Act was an outcome of an intensive 8-year work. Already in 1970, the Commission on the Bankruptcy Laws of the United States was established to explore the feasibility of a new Federal bankruptcy law to replace the outworn 1938 Act. The main idea which led the legislators to introducing the Chapter 11 reorganization as we know it today was frequently expressed in the congressional hearings.[90] On a Senate hearing, held on October 6, 1978, the following statement was made which proved the importance of the new provision:

"One cannot overemphasize the advantages of speed and simplicity to both debtors and creditors. Chapter XI allows a debtor to negotiate a plan outside of court and, having reached a settlement with a majority in number and an amount of each class of creditors, permits the debtor to bind all unsecured creditors to the terms of the arrangement. From the perspective of creditors, early confirmation of a plan of arrangement: first, generally reduces administrative expenses which have priority over the claims of unsecured creditors; second, permits creditors to receive prompt distributions on their claims with respect to which interest does not accrue after the filing date; and third, increases the ultimate recovery on creditor claims by minimizing the adverse effect on the business which often accompanies efforts to operate an enterprise under the protection of the Bankruptcy Act. […] In summary, it has been the experience of a great majority of those who have testified before the Senate and House subcommittees that a consolidated approach to business rehabilitation is warranted."[91]

Before the 1978 Act was adopted, the way how to maintain a company in bankruptcy as a going concern was very costly and troublesome. The unanimous intention of the legislators was to offer a new regime of rehabilitation for companies in insolvency that would be cheap, efficient and motivating. One of the major benefits of the Act was the introduction of the "debtor-in-possession" institute which enabled the company management to maintain a partial control of the company.

The new Act and especially Chapter 11 proved to be well-designed and thanks to several important amendments remained in force till nowadays. Among the most important amendments were those brought in by the 1984 Bankruptcy Amendments and Federal Judgeship Act, the 1986 Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act and the 1994 Bankruptcy Reform Act. The biggest changes to Chapter 7,

[90] Id. P. 1-8.
[91] 124 Congressional Recording S17417-17419 (daily ed. Oct. 6, 1978) in Bankruptcy Litigation and Practice.

governing the liquidation under bankruptcy, were introduced by The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, also referred to as the "New Bankruptcy Law". The last major attempt to amend the Chapter 11 was registered in 1997, when the National Bankruptcy Review Commission, founded by the 1994 Act, submitted its report on the reforms of the Bankruptcy Code. Nevertheless, none of the proposed changes were enacted.[92]

2.3. USBC Chapter 7

The USBC Chapter 7 is a part of the 1978 Bankruptcy Reform Act Title 11, regulating the bankruptcy liquidation. The objective of liquidation is to settle creditors' claims in a situation when a firm has filed bankruptcy with the intention to shut down and realize the value of its assets in a sale. Liquidation is the basic bankruptcy procedure and it also sets the framework for reorganizations.

Once bankruptcy is filed, a collective legal procedure is initiated which prevents the run on the debtor's assets. Otherwise, those creditors who came first would receive their claims in full and others would be left with nothing. The only situation when a creditors' race on the debtor's assets makes sense arises if any of the creditors has an insider information indicating that the firm in question already finds itself in insolvency but for some reason has not filed for bankruptcy so far. Nevertheless, once the volume of suits against the debtor's equity reached certain limit, in such a case the creditor will be forced to file for bankruptcy anyway.

After the initiation of Chapter 7 liquidation, the bankruptcy court appoints a trustee whose main responsibility is to shut the firm down, sell its assets and finally secure the payment to creditors through the court. The priority rules determine the actual recovery rate of each creditor and the moment in the proceedings when he will be paid out.

The absolute priority rule applied in bankruptcy liquidation determines that claims are paid in a specific order: first, the administrative expenses of the bankruptcy proceedings and any post-insolvency debts; second, claims with the statutory priority such as tax or rent claims and most importantly, the unpaid wages to debtor's employees which arose before the bankruptcy filing; third and finally, the unsecured creditors' claims and claims of long-term bondholders.

Secured creditors in bankruptcy liquidation stand out of the automatic priority rule ordering and they may receive satisfaction even if no one else does. Therefore, when the financial

[92] BROUDE, R. *Reorganizations Under Chapter 11 of the Bankruptcy Code.* NY: ALM Publishing, 1986, P. 1-10.

situation of a firm is deteriorating, unsecured creditors have a strong incentive to bargain for better conditions and obtain a collateral. As a result, the firm will guarantee collaterals to subsequent lenders in order to reach a lower interest rate. One of the strong arguments for maintaining the institute of securitizations despite the fact that they elicit economically inefficient behavior in situations like this one is that they decrease transaction costs to creditors who may easily control the quality of their claims if they are secured.

Once a firm in bankruptcy liquidation has paid off its creditors, it is liquidated and the unsatisfied claims expire. It does not necessarily mean that the whole firm has to be shut down. Typically in case of large companies, entire divisions may be sold to new owners and thus the going concern value and jobs may be maintained. Chapter 7 bankruptcy is also available to individuals who meet the required conditions, i.e. their income does not exceed a certain limit. Similar as in the debt-relief proceedings pursuant to the Czech Insolvency Act, their assets are then reduced to cash and the yield is used to satisfy the creditors' claims. In most cases, however, there is only little or none nonexempt property; therefore the recovery rate may be very low. Debtors are usually discharged of their liabilities within several months; however the record of the bankruptcy remains in their credit history for ten years.[93]

2.4. USBC Chapter 11

As opposed to Chapter 7, the main objective of the USBC Chapter 11 is to maintain the insolvent company as a going concern. In contrast to the Czech regulation, this may happen even if it reduces the creditors' recovery, i.e. in such situations where the realization of assets in liquidation would secure a higher yield. As a result, the Chapter 11 can be deemed more debtor-oriented than the Czech reorganization regulation.

- **Admissibility of Chapter 11 reorganization**

As a general rule, firms filing for bankruptcy may choose between liquidating under Chapter 7 and reorganizing under Chapter 11. In contrast to the Czech regulation of reorganization, Chapter 11 bankruptcy is available to every debtor, including individuals and sole proprietorships. Nevertheless, it is mostly used by corporate entities.

- **Workouts**

The law motivates insolvent firms to first attempt an informal reorganization before filing bankruptcy at a court. The so called "workouts" are favorable both to debtors and to creditors

[93] Chapter 7, available at www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx.

because court proceedings are usually costly and lengthier than an out-of-court settlement. A workout will be typically executed by renegotiating of bond covenants, negotiating a reduction in interest payments or by extending loan maturities.

In certain situations, however, it might be a preferable solution to initiate the Chapter 11 proceedings anyway because they provide the debtor with several protection mechanisms such as automatic stay or tax benefits and most importantly, they prevent potential lawsuits. Companies can also combine the advantages of both the reorganization and workout by filing a pre-packaged bankruptcy petition if a plan of reorganization has already been accepted by the creditors. Then the court proceedings may be significantly shorter.

- **Initiation of reorganization**

Reorganization under Chapter 11 may be initiated by a voluntary petition filed by the debtor or by an involuntary petition filed by his creditors. The petition is subject to a USD 1,000 case filing fee. Immediately after the filing of a bankruptcy petition under Chapter 11, the debtor starts to manage his business as a new entity, a "debtor-in-possession". In most cases, the debtor-in-possession (DIP) retains the management control of the business; in addition, he is entitled to reject certain contracts, leases or even cancel some past transactions to stabilize the business. It is also the DIP who appoints the counselors and attorneys to assist with the reorganization.

The first task of the DIP is to file all documents required by the Bankruptcy Code, including the reorganization schedules, lists of property or statements of affairs. A new bank account must be opened in the name of the DIP. After that, the DIP has to meet his creditors at a meeting of creditors to explain the reasons for filing for Chapter 11 bankruptcy and how he plans to settle their claims. The initial activities of the DIP should result in the formulating of a plan of reorganization.

- **Role of the U.S. trustee**

The United States Trustee acts in the capacity of an administrative officer, representing the court. He appoints the representative committees of creditors or other parties to the proceedings. The trustee is responsible for monitoring the DIP's business operations and submission of the operating reports and fees to the court; he may also impose certain

requirements on the DIP concerning the reporting and operational procedures. The services of the trustee are subject to a variable quarterly fee, paid by the debtor.[94]

- **Automatic stay**

With the filing of the Chapter 11 bankruptcy, an automatic stay is immediately imposed as a matter of law to help the debtor counter creditors' claims and stabilize his operations; it gives him the necessary "breathing spell" to regain control of things. As opposed to the Czech regulation, where the stay may be imposed by the court upon a debtor's request, the stay pursuant to USBC is really automatic. Over the course of the stay, all judgments, collection activities, foreclosures and repossessions of property are suspended. A relief from the automatic stay may be granted by the court when the debtor further uses secured property, thus reducing its value, or when the property in question is not necessary for an effective reorganization.[95] Ultimately, the automatic stay gives the debtor an opportunity to negotiate a plan of reorganization with his creditors.

- **Adequate protection**

Adequate protection is a bankruptcy instrument unknown to the Czech law. The purpose of adequate protection is to protect the value of the creditor's interest in the property - secured collateral - used by the DIP. Creditors may seek adequate protection in exchange for modifying the automatic stay, or as a consideration for allowing the debtor to use such property. Adequate protection is usually realized by the debtor's provision of periodic payments, replacement liens or other reliefs that give an "indubitable equivalent" to the creditor in question.[96]

- **Plan of reorganization**

The ultimate goal of the reorganization proceedings is to formulate and approve a plan of reorganization. The debtor has a 120-day period of exclusivity to file his proposal for the plan. The period can be repeatedly extended by the court but may in no event exceed 18 months. If the exclusivity period has expired, a creditor may file a competing plan. Once the plan has been completed by the debtor, he has to obtain the Court's approval of a disclosure statement, containing financial and related information about the debtor to enable the creditors to make a qualified decision on the plan in the subsequent vote.

[94] Chapter 11, available at www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter11.aspx.
[95] Id.
[96] Id.

- **Acceptance by creditors**

In order for a plan of reorganization to be accepted by the creditors, two thirds of votes in amount of claims and one half of votes in the number of claims held by the voting creditors are required. Creditors vote separately in classes, usually based on the seniority of claims. Secured creditors are deemed to have accepted the plan if at least two thirds in amount of the securities have accepted the plan. Creditors intact by the plan are deemed to have accepted the plan; those not entitled to any recovery are deemed to have declined it.[97]

In principal, parties impaired by the plan may agree to different treatment as a result of negotiations. This gives the DIB an opportunity to cure the impairment of a specific class given that such a treatment is fair and equitable. This may suspend the absolute priority rule which would otherwise prevent any distribution to junior classes of debtors until all senior classes have been paid in full. Usually, the consent of all creditors' classes is secured in the unanimous consent procedure.[98] However, the consent may also be superseded by the court through the so called cram-down, given that each class is treated fairly and equitably.

- **Confirmation of the plan of reorganization**

In order to take effect, a plan of reorganization must be confirmed by the Court at the confirmation hearing. The proposed plan must pass the "feasibility test" and the "best interest test" to achieve the Court's confirmation. The latter means that each creditor will receive a satisfaction not lower than he would receive in liquidation under Chapter 7. A confirmed plan of reorganization may only be revoked if the confirmation was procured by fraud; the motion has to be filed within 180 days of the confirmation. As a general rule, the debtor is discharged from his debts with the confirmation of the plan.

- **Conversion or dismissal of Chapter 11 reorganization**

Under certain circumstances, a Chapter 11 reorganization case may be converted into Chapter 7 liquidation or dismissed by the Court. A debtor-in-possession has a general right to convert a case which he entered voluntarily. Creditors may file a motion to dismiss or convert a Chapter 11 case for a cause – typically, if there is substantial loss to the estate, or if the DIP fails to meet his procedural and reporting duties or if he fails to effectuate of the plan of reorganization.

[97] WHITE, M. *The Corporate Bankruptcy Decision.* In POSNER, A. et al. *Corporate Bankruptcy: Economic and legal perspectives.* Cambridge: Cambridge University Press, 1996. P. 217.
[98] Id. P. 218.

- **The final decree**

Once the confirmed plan of reorganization has been accomplished and the case fully administered, the court will issue a final decree.[99]

- **Overview of the largest bankruptcy cases**

In the Table 5, the overview of the largest bankruptcy cases in the US history is displayed. Both the discussed reorganizations of GM and Chrysler ranked among the first ten.

Table 5: Ten largest US public company bankruptcy filings since 1980

Company	Bankruptcy date	Description	Assets in USD
Lehman Brothers Holdings Inc.	September 15, 2008	Investment Bank	**691,063**
Washington Mutual, Inc.	September 26, 2008	Savings & Loan Holding Co.	**327,913**
WorldCom, Inc.	July 21, 2002	Telecommunications	**103,914**
General Motors Corporation	June 1, 2009	Manufactures & Sells Cars	**91,047**
CITY Group Inc.	November 1, 2009	Banking Holding Company	**80,448**
Enron Corp.	December 2, 2001	Energy Trading, Natural Gas	**65,503**
Conseco, Inc.	December 17, 2002	Financial Services Holding Co.	**61,392**
Chrysler LLC	April 30, 2009	Manufactures & Sells Cars	**39,300**
Thornburg Mortgage, Inc.	May 1, 2009	Residential Mortgage Lending Company	**36,521**
Pacific Gas and Electric Company	April 6, 2001	Electricity & Natural Gas	**36,152**

Source: BankruptcyData.com, available at www.bankruptcydata.com/Research/Largest_Overall_All-Time.pdf

[99] Chapter 11, available at www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter11.aspx.

3. Comparison of Reorganization in the Czech Republic and in the USA

3.1. Inspiration of the Czech Insolvency Act by the USBC Chapter 11

The Czech Insolvency Act and its regulation of bankruptcy reorganization were directly inspired by the USBC Chapter 11. Despite many similarities of the two legal frameworks, there are some variances attributable to the different legal systems: while the Czech corporate law is a typical offspring of the European Civil law system, strictly governed by statutes, the American corporate law has developed from the court precedents. The United States Bankruptcy Code of 1978, although a statute by itself, still heavily relies on the judicial interpretation of many of the rules and on the power of precedents. A perfect example can be found in the case of General Motors reorganization: while a part of creditors opposed the direct sale of part of the estate pursuant to section 363, in that it constituted an impermissible "sub rosa" plan, the court dismissed their claim by pointing out an earlier application of the same rule in a similar situation by a different court.[100]

3.2. Common characteristics of the regulations and main differences

It is beyond the scope of this work to provide detailed comments on every divergence between the Czech and U.S. reorganization proceedings. Therefore, the major differences are shown in the Table 6. For the record, the U.K. receivership characteristics were preserved in the comparison.

Table 6: Comparison of main characteristics of the insolvency proceedings in the UK, the US and the CR

Characteristics	United Kingdom:	United States:	Czech Republic
	Receivership	Chapter 11	Reorganization
Managerial control	Insolvency practitioner: previous managers must relinquish control	Debtor-in-possession: in majority of cases previous managers retain control	Debtor with dispositive rights overseen by the insolvency trustee and creditors' committee
Solvency requirements	Firm cannot meet payments to creditors	Firm need not be insolvent	Firm cannot meet payments to creditors
Automatic stay against creditor claims	Substantial de facto stay in receivership and virtually complete in administration	All creditor claims stayed (exceptions- e.g., lease payments)	Facultative stay is available upon the court approval
Management of liabilities	No discretion in receivership and limited in administration	Great discretion to renegotiate claims against debtor-in-possession	Only if the claims renegotiation is part of the reorganization plan
Constraints on firm as a going concern	Must liquidate firm if value greater than going concern	Positive operating cash flow (usually) required	Minimal annual revenue of CZK 100 million or at least 100 employees

[100] In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983), In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983).

Post-bankruptcy financing	Additional finance usually from secured lenders prior to sale of the business. Other lenders in administration.	Debtor-in-possession financing available	Debtor-in-possession financing available, other modifications suggested
Preservation of residual claim of equity holders	None in receivership; some possibly in administration	In majority of cases deviations of absolute priority in favor of equity	Some possibly after the full satisfaction of all other claims
Costs	Lower because (i) short period, (ii) creditors minimally involved in process	Higher because (i) long periods, (ii) court is extensively involved in process and can delay business decisions	Usually higher because it takes longer than straight bankruptcy, may be lower in pre-packaged reorganizations

Source: Lessons from a comparison of U.S. and U.K. insolvency codes, own work

3.3. Statistical overview on reorganizations

- **Czech Republic**

- **Less than 1%** of all bankruptcy petitions in 2009 were settled in reorganization compared to **13.3% in the UK** and **5.1% in the U.S.**)
- Reorganization was so far approved in **51** cases (e.g. Papírny Vltavský mlýn, CBPS, KORDÁRNA, TOS, Henniges Automotive, Campaspol, AuTec Group)
- In contrast, the number of executed compositions throughout the operation of the 1991 Act On Bankruptcy and Composition reached **46** (from 1991 to 2007)
- Currently, 30 reorganizations are undergoing, in 16 cases the plan of reorganization was approved)
- So far, there was no example of a pre-packaged reorganization, neither was any temporary stay applied
- **Use of external financing of debtor's operation in reorganization:**
    - 40% of debtors do not use any form of external financing
    - 60% of debtors in reorganization use credit financing in the form of: bank credit, factoring and leasing, supplier credit, customer credit, extended credit from creditors, restructuring of debts
- **Preferred methods of reorganization (taken from 35 plans of reorganization):**
    - Debt restructuring (partial debt-relief): 22 cases
    - Securing the operational financing of debtor's business operations: 19 cases
    - Sale of property or its part: 15 cases
    - Transfer of assets or their part to creditors: 10 cases

Table 7: Number of approved reorganizations, 2008 - 2011

Year	Number of approved reorganizations	Conversions into straight bankruptcy
2008	6	2
2009	16	5
2010	19	8
2011 as of June 30, 2011	10	1
Total:	**48**	**15**

Source: Lee Louda, Creditreform

- **USA**

- Bankruptcy reorganization as an insolvency settlement method has a thirty-year tradition
- Reorganization is viewed as usual institute: most bankruptcy courts and insolvency lawyers have extensive experience with Chapter 11 proceedings
- Share of firms in insolvency that decide for bankruptcy reorganization heavily depends on business cycles: in times of economic crises, the number and share of straight bankruptcies rises
- Many positive and negative examples of reorganizations are available: reorganizations of General Motors and Chrysler be the positive ones, reorganization of Eastern Airlines a negative one[101]

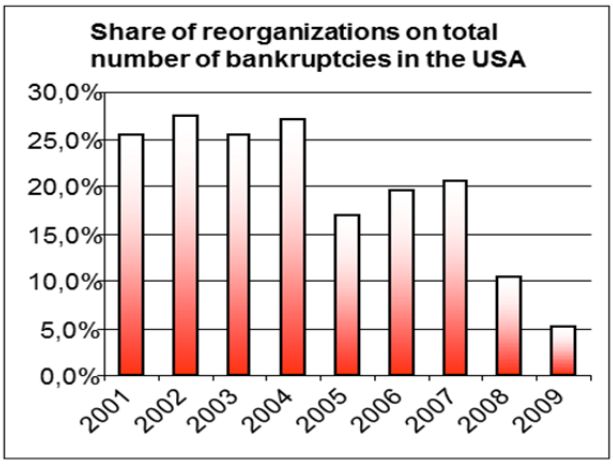
Table 8: Number of firms in insolvency proceedings in the USA, 2001 - 2009

USA	(as of 30.9.)	2001	2002	2003	2004	2005	2006	2007	2008	2009
Firms in insolvency proceedings	**Total**	38,490	39,091	36,183	34,817	34,222	27,333	25,925	38,651	58,721
Chapter 7 liquidation	**Total**	22,800	22,574	21,008	20,243	23,313	18,258	16,914	26,578	40,225
	%	**59,2%**	**57,7%**	**58,1%**	**58,1%**	**68,1%**	**66,8%**	**65,2%**	**68,8%**	**68,5%**
Chapter 11 reorganiza-tion	**Total**	9,787	10,702	9,185	9,436	5,776	5,345	5,317	4,002	3,019
	%	**25,4%**	**27,4%**	**25,4%**	**27,1%**	**16,9%**	**19,6%**	**20,5%**	**10,4%**	**5,1%**

Source: LOUDA, L. *Insolvenční řízení v praxi: Reorganizace – tříletá zkušenost.* Seminář NAXOS, 8. 6. 2011

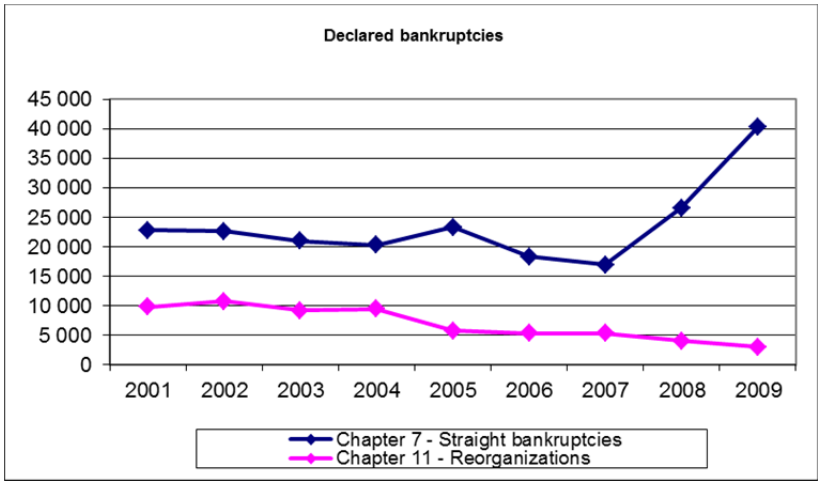
[101] RICHTER, T. *Insolvenční právo.* Praha: ASPI, 2008. P. 120.

Graph 1: Share of reorganizations on total number of bankruptcies in the USA, 2001 - 2009



Source: LOUDA, L. *Insolvenční řízení v praxi: Reorganizace – tříletá zkušenost.* Seminář NAXOS, 8. 6. 2011

Graph 2: Number of firms in liquidation vs. reorganization in the USA, 2001 - 2009



Source: LOUDA, L. *Insolvenční řízení v praxi: Reorganizace – tříletá zkušenost.* Seminář NAXOS, 8. 6. 2011

PRACTICAL PART: COMPARISON OF REORGANIZATION PROCEEDINGS OF KORDÁRNA AND GENERAL MOTORS

4. Reorganization of Kordárna

Reorganization of Kordárna is one of the few examples of a successfully completed reorganization under the new Czech Insolvency Act. According to the available statistics, only five reorganizations of insolvent corporations were accomplished so far, 30 other companies are in reorganization at the moment. Compared to the average 157 straight bankruptcies declared monthly in 2011, the statistics do not seem to be very encouraging. However, there are several explanations of this adverse state.

First, the Insolvency Act and also the reorganization method of insolvency settlement are only available since 2008 therefore more reorganizations could not be completed simply as a matter of time. True, the core of the insolvency proceedings of Kordárna was completed within one year (as of August 2011, Kordárna, a.s. was still in liquidation), however the average length of insolvency proceedings in the Czech Republic was still 6.5 years in 2009. And although the Insolvency Act strictly limits the duration of single procedural phases and even the creation of the plan of reorganization cannot take any longer than 240 days, reorganization as such will be usually a very complex and demanding process that can take years.

Second, the lack of experience and knowledge among all subjects participating in insolvency proceedings often lead to immediate declaration of straight bankruptcies, without having even considered reorganization. The situation should gradually improve over time but more positive examples are needed to persuade the creditors that voting for reorganization is not just wasting time but that it can actually help them satisfy their claims to a greater extent.

Third, despite the declared purpose of the Insolvency Act to guarantee a greater protection of the rights of creditors, more incentives should be incorporated in the law to make the institute of reorganization more attractive for all. If the big and secured creditors with majority claims can easily outvote smaller creditors, not only it is economically inefficient but it can even harm these big creditors in the long term. In a model situation where a large bank has a secured claim against a middle-size manufacturer and a good chance of successful reorganization exists, then if the bank decides for straight bankruptcy, the jobs and the going

concern value of the firm are lost and a prospective future client of the bank dies. If such cases are multifold, as in the times of economic downturns, the revenues of the "once clever" bank will also drop.

Finally, it might be useful to think of a wholly new way how to motivate both creditors and debtors to seek an economically rational solution. Similarly as indebted individuals learned to use the institute of debt-relief because it is motivating for them given the relatively low required payback rate, some sort of bottom limit of claim satisfaction could be set from which the court could approve debtor's reorganization plan against the will of creditors. Although there is a legal possibility for the court to overrule the majority vote given that at least one class of creditors has accepted the plan,[102] such a scenario is highly unlikely because the majority creditors will tend to compensate the opposing creditors. Now the court could apply this modified "cram-down" and approve the plan simply if it met the requisite tests. Naturally, such an institute would only make sense if the expected yield of straight bankruptcy would be relatively low. Given the average recovery rate in bankruptcy was 21% in 2009, then the limit could be set at 30% as in case of the debt-relief and gradually increased over time.[103]

4.1. Basic facts about Kordárna

Picture 1: Headquarters of Kordárna in Velká nad Veličkou

Source: www.kordarna.cz

[102] § 348, art. 2, Insolvency Act, No. 182, 2006.
[103] World Bank, *Czech Republic: Effective Insolvency and Creditor Rights Systems*. eStandardsForum, 2010.

Kordárna, a joint stock company, is one of the major European producers of technical fabrics. The key products of the company are industrial textiles for tires, transport conveyers and geosynthetics (geotextiles and geogrids) for the building industry. The company is based in Velká nad Veličkou close to the Czecho-Slovak border. Kordárna is the core member of the KORD Group.

The company was established in 1948 by the world-renowned company Baťa Zlín to serve as major supplier of technical fabrics for Baťa. The production was started in 1950 with the initial annual capacity of 4,000 tons of fabrics. Kordárna was the first large manufacturer in the region and became the leading industrial employer soon. Starting with the production of cotton-based fabrics, the company soon extended its product portfolio by artificial materials, e.g. viscose-silk or polyamide-based fabrics. At the end of 1950s, the production of Kordárna reached 8,000 tons per year and employed almost 700 associates.

In 1960s, the company heavily invested into extensions of the production and strengthened its own research and development, including the training of own experts. It also started with the production of technical fabrics for conveyor belts and V-belts. The production reached 11,000 tons of fabrics annually and the number of employees rose to almost 1200.

In the following decade, the production of high-strength polyamide fabrics rose significantly to satisfy the needs of the developing rubber-industry in Czechoslovakia. Kordárna further invested into new capacities and automation of the production processes to increase the quality of output. The production gradually rose to 18,000 tons annually.

In 1980s, Kordárna became the largest producer of technical fabrics in Europe and employed new technologies some of which are used until today.

After the dissolution of USSR and change of the economic realities, the company was privatized in 1994 and the new owners started an overall modernization. The company employed modern computerized production processes and strengthened its orientation on customers. In 1996, Kordárna was awarded the ISO 9001 Quality Management System certificate, started with the outsourcing of supporting processes and increased the production to 30,000 tons annually.

The second big wave of modernization started with the new millennium aiming at the increase in efficiency and quality of production. The total value of investments surpassed EUR 20 million in a short period. A huge project was started after an acquisition of a Slovak fabrics

producer Slovenský hodváb in 2005. Because the capacities and technologies in the Slovak factory were not sufficient, Kordárna decided to build a new factory on a greenfield site in the value of EUR 40 million. Nevertheless, the investment turned out to be highly undervalued and exceeded its financial reserves. Followed by a significant drop in sales as a result of the financial crisis, the company soon became insolvent.

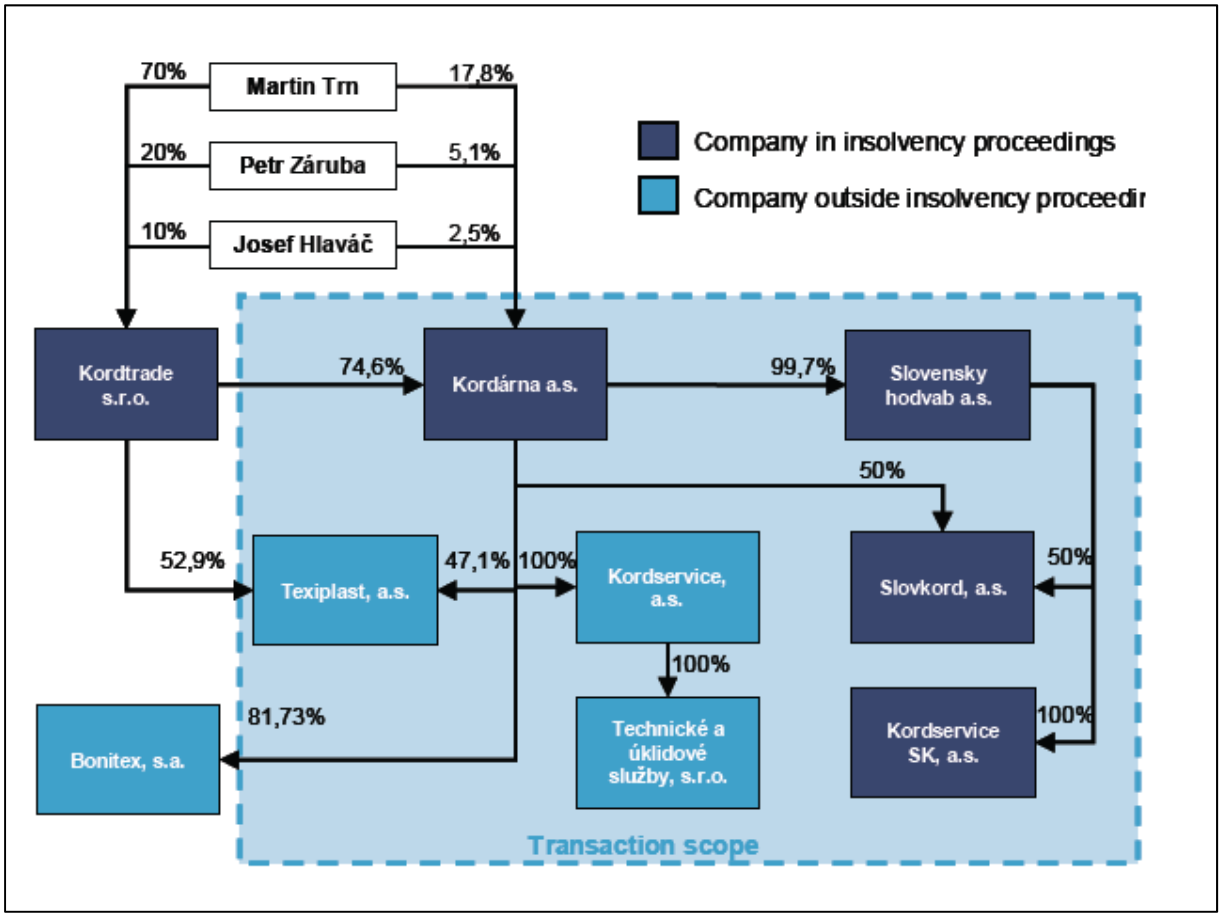
On May 14, 2009 the court declared bankruptcy of Kordárna but already in August 2009, a plan of reorganization for the company was approved. The reorganization process was finished in May 2010 by the sale of the newly created entity Kordárna Plus, a.s. to a Czech investment group Cefeus Capital, a.s. The yield of this sale was used to settle the outstanding creditors' claims. Thanks to the fast and smooth reorganization process, the production had never been discontinued and the new owner has big plans for the future.

Now, the company concentrates on the development of its geotextile fabrics production program for the construction industry and plans to reach an annual turnover of EUR 350 million soon. The target production capacities after the realization of the planned investments are 45,000 tons annually.

The KORD Group comprises several companies connected by the production of technical fabrics. The member companies can be divided into three groups:

1. Companies producing technical fabrics for tires, belt conveyors and geosynthetics for the construction industry: Kordárna, a.s., Texiplast, a.s. (based in Slovakia), Bonitex, S.A. (based in Poland).
2. Producer of polyester fibers Slovkord, a.s. (based in Slovakia).
3. Sales and service companies securing the support for the whole group: Kordtrade, s.r.o., Kordservice, a.s., Kordservice SK, a.s. (based in Slovakia).

Diagram 1: Extent of insolvency proceedings within the KORD Group



Source: PwC, *Causes and settlement of the insolvency of Kordárna*. Presentation for the students of VŠE

4.2. Causes of the insolvency

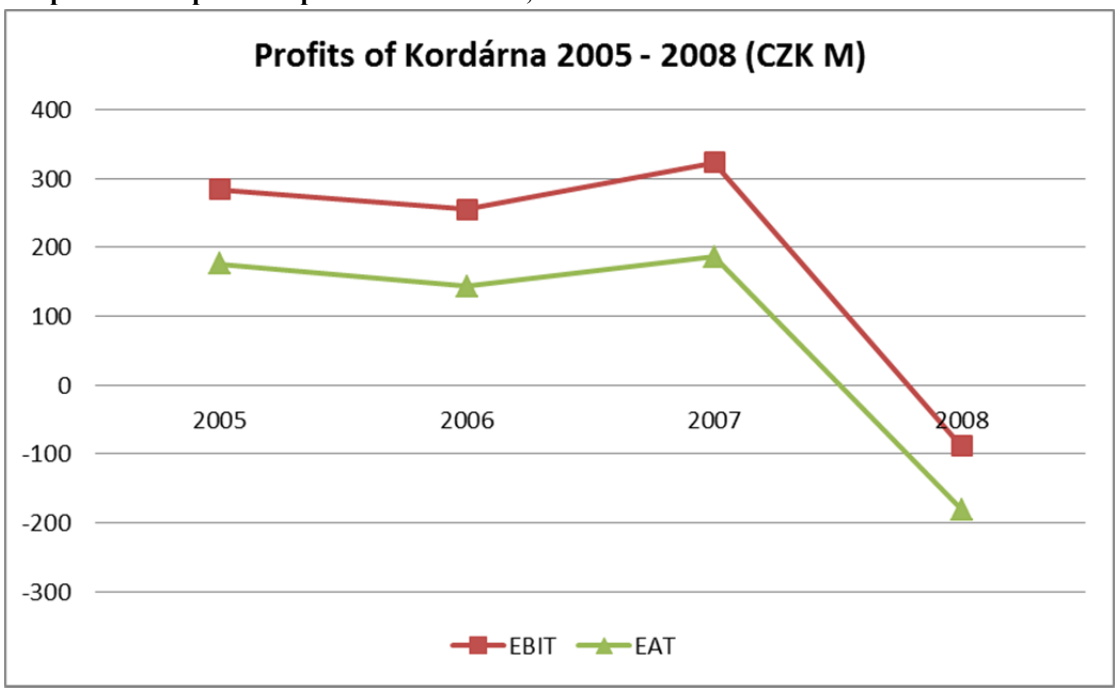
There were two major causes that led to the insolvency of Kordárna and ultimately to the filing of bankruptcy petition in 2009: an internal cause - mismanaged investment project in Slovakia - and an external cause - global financial crisis that precipitated the drop in sales in almost all product categories. The combination of those two factors - an urgent need to finance the investment on one side and declining revenues on the other side - brought the company in a seemingly helpless situation.

Where and when did the crucial mistakes happen? And was there any chance to prevent this scenario? From the perspective of the then management of Kordárna, the insolvency was probably inevitable. They got entrapped in the plans of their own which made the new investment a priority No. 1. However, from the perspective of an economist, the greenfield investment should have been viewed as a sunk cost once it was clear that the company had lack of resources to finance its completion. One of the basic theories in economy says that past expenses must not affect our future decisions. The main mistake of the management was

therefore to continue with the project under the existing economic conditions. If they decided to postpone the investment till the market recovery and managed to rationalize the remaining operations, there was a good chance to avoid the insolvency.

After a decade of a strong growth started by the privatization of Kordárna in 1994, the company prepared a challenging investment plan which counted with the extension of production capacities from 30,000 tons to 45,000 tons annually in a few years' period. The markets, however, were not ready to absorb such a growth. In fact, the effects of the economic crisis, among them the decrease in demand for new cars all around the world resulted in a 20% drop in sales revenues.[104] In 2008, 70% of sales of Kordárna comprised technical fabrics, 24% materials for conveyor belts and only 6% geotextiles. Given that out of the first 70%, most of the output is sold to car tire manufacturers who only demand part of their input externally, having their own stable production capacities, the real impact of the crisis was even greater. In the Graph 3, the development of profits from 2005 to 2008 can be seen.

Graph 3: Development of profits of Kordárna, 2005 - 2008



Source: Annual reports of Kordárna, own work

As described below, the criteria for declaring bankruptcy pursuant to the Insolvency Act, were clearly met:[105]

[104] Annual Report 2008, Kordárna.
[105] § 3, Insolvency Act, No. 182, 2006.

- **Multitude of creditors**

Following the declaration of bankruptcy, the insolvency trustee received more than 100 claim registrations. The first condition for declaring bankruptcy was met.

- **Liabilities more than 30 days overdue**

In the critical period at the beginning of 2009, Kordárna generated negative cash flow and did not have sufficient liquidity for securing the continued production, let alone for repaying the debts. The situation deteriorated after the filing of the petition for bankruptcy because most suppliers required advance payment. The second condition was also met.

- **Inability to pay back the liabilities**

Since Kordárna did not have any free cash, there was little or no chance to obtain funds for paying back their existing liabilities. In April 2009, the company was not able to pay the majority of its accounts receivable. Thus the third condition for declaring bankruptcy was met too.

- **Overindebtedness**

Also the criterion of overindebtedness was met because the total value of all debts of Kordárna significantly exceeded the value of its equity and there was no reason to believe that the situation would significantly improve in the near future. Beginning with the new wave of investments, initiated in 2004, the company gradually increased the volume of its debts and excessively relied on the growth in the markets, creating little or no reserves. When the financial crisis came in 2008, the debt/equity ratio skyrocketed to 184%, the debt exceeding equity by CZK 950 million.[106]

4.3. Reorganization proceedings

At the end of 2008, the management of Kordárna, a.s. finally realized that it was not possible to complete the investment project in Slovakia on the existing bank syndicate credit and that their own cash flow deterioration would ultimately lead to insolvency of the whole group. After several rounds of negotiations with banks concerning an extension of existing credits and an intensive search for a strategic investor, the management finally decided to file a petition for bankruptcy at the Regional Court in Brno[107] on April 30, 2009.[108] The bankruptcy involved Kordárna and three other companies of the KORD Group, financed from the joint

[106] Annual Report 2008, Kordárna.
[107] For general information on the system of courts in the Czech Republic and their jurisdiction refer to http://ec.europa.eu/justice_home/judicialatlascivil/html/pdf/org_justice_cze_en.pdf.
[108] Filing, available at isir.justice.cz/isir/ueu/evidence_upadcu_detail.do?rowid=AAAE1DAAXAAFZT2AAu.

bank syndicate credit. In the petition for bankruptcy, the company announced its plan to settle the insolvency through reorganization and on June 10, it delivered the motion for approval of reorganization to the court. Kordárna met the quantitative conditions of reorganization; in 2008 revenues of the company reached CZK 2,755 million and the number of employees was 538.

The insolvency proceedings were initiated on the following office day, on May 4, 2009, with an experienced insolvency judge Jan Kozák in charge. On May 14, 2009, the court issued the declaration of bankruptcy.

Under the new circumstances, the creditors and trade partners demanded a change in the company management which led to the nomination of Radim Valas in the position of CEO and Ivo Lazecký in the position of CFO. Along with the current executive director Martin Prachař, they formed a strong and experienced crisis management unit. New managing board was nominated on a special general meeting on June 12, 2009. The team sought economic support from PricewaterhouseCoopers CR, the role of legal counsel was entrusted to Radek Bláha from Horák & Chvosta law office,[109] the external communication was managed by Svengali Communication.[110]

The primary objective of the new crisis management team was to maintain the operations, come up with a new strategy that would help stabilize the company financially, and prepare the plan of reorganization. Special task forces were created, responsible for the cost-cutting, improving the efficiency of operations, creation of the plan of reorganization and for the sale of residual assets.[111]

On the operations side, the production was limited to four weekdays in three shifts, 137 out of 537 employees were laid off. Thanks to the adopted cost-cutting program, operational and investment expenses were curtailed to maintain operational profits and generate positive cash flow. The cash was secured by selling the accounts receivable to a factor. In July 2009, the financial situation was stabilized and since August 2009, a positive cash flow was achieved every month which enabled the company to cover their newly emerging account payables.[112]

[109] As of April 1, 2011, Horák & Chvosta were merged with White & Case, LLP.
[110] Report on the activities No. 1, available at isir.justice.cz.
[111] PwC, *Causes and settlement of the insolvency of Kordárna*. Presentation for the students of VŠE, Velká nad Veličkou, 19.11.2009.
[112] Report on the plan of reorganization, available at isir.justice.cz.

- **Timeframe of the reorganization proceedings:**

- On April 30, 2009, Kordárna along with its three daughter companies filed a bankruptcy petition at the Regional Court in Brno. In the petition, the company demanded that the court approves reorganization of the business.
- On May 4, the Court initiated the insolvency proceedings by publishing a notice in the Insolvency register.
- On May 14, the Court issued declaration of bankruptcy concerning all four companies. On that day, the 30 day term for submitting creditors' claims began to run.
- On June 10, Kordárna filed a motion for the approval of reorganization to the Court.
- On June 23, the first creditors' meeting took place, following the Court's call. The creditors' committee was elected, representing all four creditors' classes: 1) Česká spořitelna, a.s. as the only secured creditor, 2) 93 unsecured nonbank creditors, 3) 5 unsecured bank creditors, 4) 4 members and partners of the debtor.[113] Česká spořitelna was elected for the chair of the committee.
- Following the first claim review meeting held on August 4, a new insolvency trustee was elected. Lee Louda replaced Miroslav Sládek in his function on August 7. Creditors also agreed on accepting the proposed reorganization.
- On August 7, the Court approved reorganization of Kordárna. As a debtor-in-possession, the company regained part of the property disposition rights, the general meeting was forfeited some of its rights to the trustee.
- As of August 10, the 120-day term for the creation of the plan of reorganization started to run. Due to the complex character of the case, the Court extended the term by another 120 days. On the same day, the Court appointed the expert responsible for the valuation of the property, the company Equita Consulting s.r.o.[114]
- On September 23, a public tender was announced for the sale of a newly created entity Kordárna Plus, a.s., playing the key role in the plan of reorganization. Prospective buyers were asked to give a security in the value of EUR 1 million.
- On December 19, Equita Consulting submitted the expert opinion, containing the evaluation of the business of Kordárna.
- On January 15, 2010, the term for submitting buyers' bids for Kordárna Plus expired.

[113] Pursuant to § 335, art. 1 of the Insolvency Act, members and partners of the debtor are considered creditors in reorganization too.
[114] The purpose of the valuation is to bring a complex picture of the value of the property if the company was liquidated in straight bankruptcy and the value reflecting the proposed way of reorganization.

- On January 21, the creditors' committee acknowledged that the highest bid in the total value of CZK 795.6 million was placed by Cefeus Capital, a.s.
- On January 29, the transaction was executed.
- On March 9, the debtor submitted the report on the plan of reorganization to the Court which approved the report three days later.
- On the creditors' meeting held on March 30, the present creditors of all four creditors' classes voted for the plan.
- On April 1, 2010, the Court approved the plan of reorganization.
- On May 10, 2010, the sale of Kordárna Plus, a.s. to Cefeus Capital, a.s. was approved in the creditors' meeting.
- On April 26, 2011, the insolvency trustee submitted the yet latest interim report on his activities to the Court. In the report, the trustee mentioned that he initiated steps required for closing of the liquidation of the debtor and started collecting documents needed for the Report on the accomplishment of the plan of reorganization.
- According to the approved plan of reorganization, the reorganization should have been accomplished by June 30, 2011. This along with the situation described above implies that the whole reorganization proceedings of Kordárna, a.s. will be completed soon.

- **Overview of creditors' claims**

The total of 107 creditors' claims in the value of CZK 5.8 billion was registered by the Court within the 30 days of the declaration of bankruptcy. The largest and the only secured creditor at the same time was Česká spořitelna, a.s., seeking a CZK 2.6 billion claim. The second largest claim arose from the bank syndicate credit in the total value of CZK 1.8 billion, granted by ABN Amro Bank N.V. (CZK 1.1 billion), Komerční banka, a.s. (CZK 231 million), Raiffeisenbank a.s. (CZK 220 million), Calyon S.A. (CZK 165 million) and OTP Banka Slovensko, a.s. (CZK 132 million).

The greatest part of the registered claims comprised the bank credits but Kordárna owed money also for supplied resources, sales and legal services, health insurance or for energies. The claim of Česká spořitelna was secured by diverse assets of the company, e.g. land and buildings, machinery, technologies or licenses. Out of the 97 unique creditors, 25 were based abroad.[115]

[115] Report on the Plan of Reorganization, available at isir.justice.cz.

Table 9: List of ten largest creditors of Kordárna and their claims

No.	Creditor	Recognized claim	Denied claim	Registered claim
62	**Česká spořitelna, a.s.**	**2,605,895,196**		2,605,895,196
72	**ČR – Správa st. hmotných rezerv**	**27,811.32**	58,863,165.98	58,890,977.30
59	**KORDSERVICE, a.s.**	**51,872,961.87**		51,872,961.87
94	**China Shenma Group Co. Ltd.**	**35,215,947.60**		35,215,947.60
23	**E.ON Energie, a.s.**	**22,381,149.83**		22,381,149.83
79	**MITSUI & CO., LTD.**	**20,173,135.53**		20,173,135.53
28	**JSC Grodno Khimvolokno**	**17,137,385.69**		17,137,385.69
67	**Nexis Fibers, a.s.**	**13,201,690.49**		13,201,690.49
92	**Longlaville Performance Fibers SAS**	**8,550,735.92**	479,187.35	9,029,923.27
48	**Technické a úklidové služby s.r.o.**	**5,403,657.90**		5,403,657.90

Source: Zpráva o reorganizačním plánu, isir.justice.cz

- **Proposed Organizational Changes as in the Plan of Reorganization**

For each of the four entities in bankruptcy, the crisis management team proposed a complex restructuring scheme. The principals of the plan are listed below:

- **Kordárna:** Split-off of the "healthy" assets and their transfer into a newly created entity – Kordárna Plus, a.s. Sale of the new company to a strategic investor and payoff of the creditors from the yield of the sale. Liquidation of the old Kordárna, a.s.
- **Texiplast:** Sale of the minority stock package, owned by Kordárna, along with Kordárna Plus. Decision on the sale of the majority part depending on the plans of the new owner of Kordárna Plus.
- **Slovkord:** Split-off of healthy assets in the package "Slovkord", sale to a strategic investor, payoff of the creditors.
- **Kordservice SK:** The core of reorganization based on the swap of assets with Slovenský hodváb. Part of the company along with the new assets to be sold to a new investor, payoff of the creditors.
- **Slovenský hodváb:** Sale of the assets, payoff of the creditors.

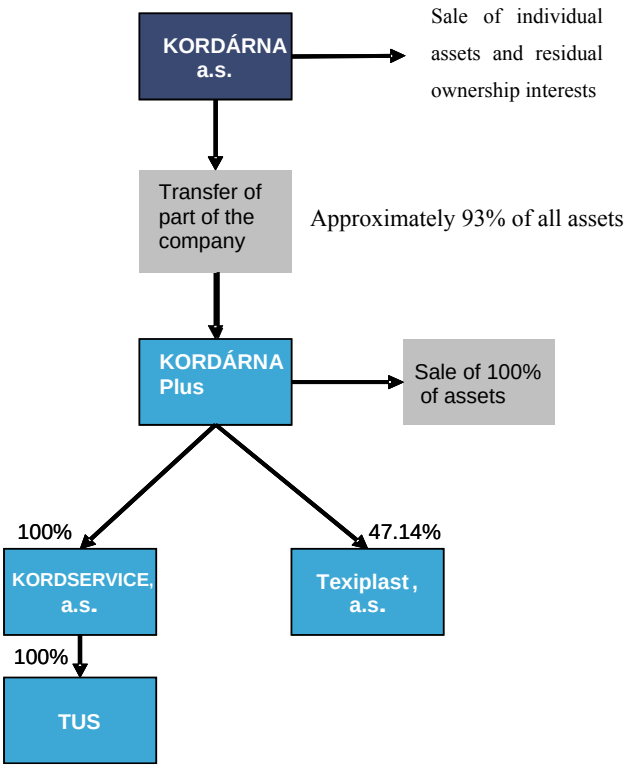
As noted above, the key part of the reorganization proceedings was the creation of the new entity Kordárna Plus, a.s. and its sale to a strategic investor, who would ideally maintain the production in Velká nad Veličkou. The investor arose from the public tender, announced on September 23, 2009. In the valuation report by Equita Consulting, submitted on December 19, 2009, the market value of the company was estimated to be at CZK 708.7 million.[116]

[116] Expert opinion No. R10348/09, 21.12.2010, p. 121. Available at isir.justice.cz.

Therefore any bid higher than that would have been acceptable for the company and their creditors.

The property of Kordárna Plus, a.s. included all machinery and equipment of the existing production facility, land, buildings, certificates and licenses, contracts with trade partners, employee contracts and post-insolvency liabilities. The new entity was clear of any past debts and had working capital available to finance the production. The offer included also the property participations of the original Kordárna, namely a 100% share in the facility services providers Kordservice, a.s. and Technické a úklidové služby, s.r.o., and a 47% share in the Slovak geotextiles producer Texiplast, a.s. The crisis management of Kordárna believed that the new company would guarantee high profitability of production and belong among the best in the business.

Diagram 2: Property structure of Kordárna Plus, a.s.



Source: LOUDA, L. *Insolvenční řízení v praxi: Reorganizace – tříletá zkušenost.* Seminář NAXOS

- **Sale of Kordárna Plus in the public tender**

On September 23, 2009, a public tender was announced for the sale of Kordárna Plus, a.s. One of the conditions for the participants in the tender was to give a security of CZK 1 million to prove their genuine interest. More than ten companies demonstrated their interest to

participate in the tender, five of them submitted their bids.[117] On January 21, the management of the company announced that the highest bid was placed by the Czech investment company Cefeus Capital, a.s. The transaction in the value of CZK 795.6 million[118] was executed on January 29, 2010, the whole sale price was paid on March 26, 2010. In its bid, Cefeus Capital declared their interest in maintaining the production in Velká nad Veličkou and in continued expansion of the production to return on 2007 sales levels within five years.[119] Than plan of reorganization suggesting the sale of Kordárna Plus was approved by the creditors' committee on March 30, 2010, the sale to Cefeus Capital was approved on May 10, 2010. The other three companies were sold in a package to the investment company Santini Capital, a.s., also a member of the JET Investment group. The total value of both transactions thus reached CZK 920 million.[120]

- **Basic facts about Cefeus Capital, a.s.**

Cefeus Capital, a.s. is under 100% control of the Czech investment group JET Investment, a.s. JET Investment, established in 1997 is fully owned and managed by Igor Fait. According to the information published in their web presentation, the group concentrates on identifying of investment opportunities in manufacturing industry and real-estates. The investments are often realized in syndicates, combining the equity of the group and other private investors, acquired companies are usually bought through special purpose vehicles. In the past, JET Investment successfully completed acquisitions and restructuring of companies such as Českomoravský len, a.s., Vinium a.s., Adast Blansko a.s. or Hutní montáže, a.s. in total value of several billion Czech crowns. Besides Kordárna Plus, a.s., the group is currently realizing the restructuring projects of Strojírny Poldi, a.s. or PBS Industry, a.s., both traditional Czech manufacturing companies with a long history.

- **Satisfaction of creditors**

The plan of reorganization, approved on April 1, 2010, included the calculation on the expected satisfaction rate of creditors' claims, following the sale of Kordárna Plus.[121] Compared to the data on the expected satisfaction in the event of straight bankruptcy, as indicated in the previously published expert opinion,[122] the reorganization brought much higher yields both to secured and unsecured creditors from the classes 1 and 2. The

[117] LOUDA, L. *Insolvenční řízení v praxi: Reorganizace – tříletá zkušenost.* Seminář NAXOS.
[118] Report on the Plan of Reorganization, available at isir.justice.cz.
[119] JET Investment: *Actual projects, Kordárna Plus a.s.* Available at www.jetinvestment.cz,.
[120] ČTK, *Cefeus Capital může koupit Kordárnu, ÚOHS povolil*. 10. 5. 2010.
[121] Report on the Plan of Reorganization, p. 27. Available at isir.justice.cz.
[122] Expert opinion No. R10348/09, 21.12.2010, p. 121. Available at isir.justice.cz.

satisfaction rate of the secured claim of Česká spořitelna, a.s. reached 15.21% compared to 10.98% in the event of straight bankruptcy, the satisfaction rate of unsecured creditors was more than fourfold: 8.17% compared to 1.98%.

Table 10: Satisfaction of creditors of Kordárna

Satisfaction of creditors (CZK in millions)				
	Secured claims (ČS)		Unsecured claims	
Settlement method	Straight bankruptcy	Reorganization	Straight bankruptcy	Reorganization
Registered claims	3,459.532	3,459.532	5,242.756	3,651.780[123]
Satisfaction rate (in %)	10.98 – 11.00	15.21	1.98 – 2.00	8.17
Expected satisfaction	379.924	526.187	104.081	298.317
Difference		143.263		194.236
Difference (in %)		38.50%		286.62% (411.49%)

Source: Plan of reorganization, expert opinion

Creditors from classes 3 and 4, i.e. unsecured conditioned bank creditors and creditors pursuant to § 335 of the Insolvency Act would not receive any satisfaction in either of the two scenarios.

4.4. Evaluation of the reorganization proceedings of Kordárna

The reorganization process of Kordárna, a.s., including the transformation of the old company into the successional entity Kordárna Plus, a.s., can be viewed positively. At the beginning of 2009, Kordárna found itself in the state of insolvency and many believed that a liquidation of the company was inevitable. The key customer, Continental, terminated its cooperation with Kordárna, others limited their orders following the economic downturn and Kordárna was left with no chance but to declare bankruptcy.

However, a little miracle followed. The creditors of Kordárna, among them the only secured creditor Česká spořitelna, a.s. understood the depth of situation and soon, they came up with a plan of reorganization, a new insolvency institute that no one had an experience with from the past. Nevertheless, the strategy of reorganization proved to be successful and in the end, it brought both the secured and unsecured creditors a satisfaction much higher than they would have received in usual straight bankruptcy proceedings.

The key factor that led to the success was the selection of skilled and experienced people who administered the reorganization in a fast and efficient way, among them the crisis manager Radim Valas, the insolvency trustee Lee Louda and the insolvency judge Jan Kozák. All three

[123] The total value of unsecured claims in the event. of reorganization does not contain the conditioned claim of Česká spořitelna, as explained on p. 105 of the Expert opinion.

parties to the process, the management of the company, the insolvency trustee and the Regional Court in Brno demonstrated their willingness to cooperate and their knowledge of crisis management. Thanks to them, the reorganization was approved within three months of the initiation of the insolvency proceedings, the sales process of Kordárna Plus started one month later and the whole transaction was completed within one year, in May 2010. Over this time, the production was maintained and soon, the insolvent company was able to secure the working capital from its own resources.

Besides the fact that the reorganization of Kordárna was the first major successful example of reorganization after the introduction of the new Insolvency Act, there were several pioneering solutions applied in the process.[124] It was the first major business concern insolvency proceedings in the Czech Republic where four reorganizations were led by one insolvency judge and one trustee. At the same time, the principle of the so called "COMI" (Center of Main Interest) insolvency proceedings was applied which enabled the execution of all four of these reorganizations in Brno, Czech Republic and saved both costs and time. Finally, the expected costs of the reorganization reached ca. CZK 40 million, i.e. 4.4% of the yield brought in by the sale of Kordárna Plus and the other three entities to JET Investment. Last but not least, the successful process was strongly supported by the economic and legal advisors with a great expertise in this field – PwC CR and Horák & Chvosta.

Concerning the future of Kordárna Plus, a.s. and its operations, the acquirer Cefeus Capital, a.s. already announced that it planned to gradually increase the production so as to reach the levels of 2007 until 2015, offer a job to part of the laid-off employees and secure new contracts in the eastern markets. The current economic results of the company indicate that the restructuring process started in 2009 not only improved the efficiency and productivity of Kordárna but given the continued recovery from the crisis in the key markets, the 2015 objective could be reached even earlier. The investor also confirmed the plan to follow through on the investment in Slovkord that drew the old Kordárna into the insolvency. Ultimately, the JET Investment intends to sell Kordárna Plus to an investor from Asia.

[124] LOUDA, L. *Insolvenční řízení v praxi: Reorganizace – tříletá zkušenost.* Seminář NAXOS.

5. Reorganization of General Motors

The 2009 General Motors (GM) bankruptcy was a long awaited decline of one of the largest car producers in the world. Many believe that the reasons of the recent bankruptcy lie deep in the past. Already in 1970s, they say, the automobiles made by GM slowly started to lag behind the competitors and the rocket-speed entering of Japanese brands in 1980s sealed its fate. Despite many attempts, the company never managed to come with an innovative strategy that would slow down the gradual diversion of the consumers. The GM cars were steadily underperforming in several aspects: technology, operational efficiency, reliability or service. Most customers remained loyal to the brand only because of the design, comfort or convenience of their cars, an important role played also the purchase price.

The gravity of these concerns fully proved in 2007 when the fuel prices rose dramatically and the consumers realized that they were not able to operate their cars on a daily basis any more without cost-cutting in other areas.

Picture 2: General Motors Headquarters in Detroit

Source: Wikimedia Commons

5.1. Introduction of General Motors

The General Motors Company (GMC) is an American carmaker based in Detroit, Michigan. It was founded in 1908 in Flint, Michigan by William C. Durant. Today, GMC is the world's second largest car producer after Toyota, selling 8.5 million cars annually. GMC cars are marketed in ca. 160 countries under several different brands, among which Buick, Cadillac, Chevrolet, GMC, Opel and Vauxhall are the best known. In 2010, GM employed over 200,000 people in almost 100 production plants all around the world and reached annual revenue of USD 136 billion.[125]

The history of GM started in 1907 when an American carriage producer and Ford dealer William C. Durant founded General Motors of Canada together with R.S. McLaughlin. A year later, on September 16, 1908, Durant started the General Motors Holding Company as a holding company for Buick. Later that year, he acquired Oldsmobile and in 1909, he introduced several other brands into his portfolio, among them Cadillac or the predecessor of Pontiac. Due to an unsuccessful attempt to acquire Ford in 1910, Durant lost his control of GM and left the company. In 1911, he co-founded the Chevrolet Motor Company with Louis Chevrolet. Along with McLaughlin, he managed to buy back the GM in 1916 and established the General Motors Corporation.

The following decade brought many important changes to GM. In 1923, they moved their headquarters to Detroit. In 1925, GM acquired the English carmaker Vauxhall followed by the acquisition of majority share in German Opel in 1928. At the end of 1920s, GM surpassed Ford thanks to their consumer credit program which made it much more affordable to customers to buy new cars.

In 1930s, GM extended the scope of their operations by aircraft production and after its start of the Greyhound bus line and United Cities Motor Transit, if faced accusations of attempting to replace railroad transportation with their buses. In 1935, the United Auto Workers (UAW) labor union was formed and two years later, the management of GM recognized the UAW as an official representative of its workers.

During the World War II, GM was involved in the cooperation with Nazi Germany through its Opel subsidiary, reportedly a highly profitable one for the company. After declaring that they have discontinued their operations in Germany, GM received substantial tax

[125] Annual report 2010, GM.

compensation from the Government, later it received another compensation in the form of war repatriations.

After the war, GM recorded a period of strong growth and further reinforced their position of the world leading carmaker. The 1960s to 1980s were a period of stabilization for GM's business; however the company's reputation was repeatedly flawed by wrongly designed and faulty models. Despite its declared plan to start with production of smaller and more fuel-efficient models, GM focused more and more on larger vehicles and SUVs.

At the beginning of 1990s, GM faced a significant decline after the Gulf War crisis and unsuccessfully attempted to enforce quotas on the growing imports of Japanese and Korean cars. Still, thanks to a strong market grow, GM maintained sound profits till the end of the decade.

Another crisis came after the September 11, 2001 attacks that forced GM to restructure their costly retiree health care and post-employment benefit programs. Further employee cost-cutting efforts, started in 2006, resulted in the UAW union strike in September 2007. The deteriorating financial position of the company led GM to offer buyouts to the labor union members in February 2008. Despite the efforts to stabilize the financial situation of GM, the impacts of the global financial crisis made the company file for Chapter 11 bankruptcy reorganization on June 1, 2009.

5.2. Causes of the bankruptcy

The causes leading to the 2009 General Motors reorganizations were multifold and any single of them would not be sufficient to bring about the financial distress of the company. In principle, they can be divided into three groups:

1) **Historical legacy costs of the company**

   As suggested in the historical overview, GM has been heavily unionized throughout its modern history. The United Auto Workers labor union, founded in 1935, developed a strong bargaining position over time and it became almost impossible for the management to modify the workers' compensation and benefits without the consent of the UAW. Together with growing living standards, a costly system of benefits was introduced. GM attempted to reduce their expenses on the legacy costs repeatedly but the labor union representatives were only willing to accept too small concessions to reverse the deteriorating financial situation of the company. In comparison with the

non-unionized Japanese producers, the employee costs of GM were significantly higher despite the fact that the hourly wages were at a similar level. As shown in the Table 11 below, GM paid as much as USD 25 in excess of what Toyota did.[126]

Table 11: Costs of labor in the "Big Three" in 2006

Costs of labor and retiree-to-worker ratio in 2006					
	Daimler-Chrysler	Ford	General Motors	Toyota	All private sector
Average hourly compensation	USD 75.86	USD 70.51	USD 73.26	USD 48.00	USD 25.36
Retiree-to-worker ratio	2.0	1.6	3.8	-	-

Source: UAW Workers Actually Cost the Big Three Automakers $70 an Hour, www.heritage.org

Another major financial burden was established by the so called Jobs Bank programs, introduced in the 1984 UAW labor contracts. The purpose of these programs was to support laid off employees of the "Big Three" U.S. carmakers whose jobs became obsolete due to the automation of the production process. The programs should have guaranteed the lost wage compensation and cover costs of retraining, but in reality, those affected could receive the support till the end of their lives. GM only paid over USD 500 million in Jobs Bank payments every year.[127]

2) Global financial crisis

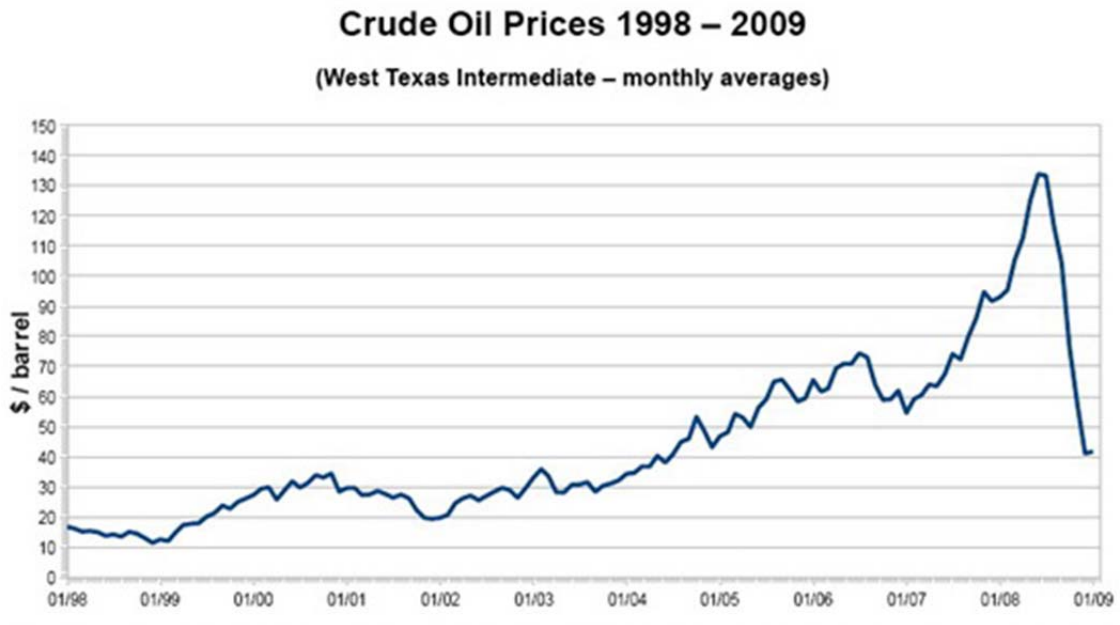
After the successful years at the turn of the century, GM's focus on big cars showed its first weak points. Since 2003, oil prices started to grow dramatically and American consumers slowly realized that their SUVs had significantly higher operating costs than small sedans, offered mainly by the Japanese producers. As a result, GM lost USD 51 billion even before the 2008 financial crisis began.

In 2005 GM's plants were operating at 85% capacity which together with the legacy costs and sales incentives to buyers incurred significant losses. Compared to their Asian competitors, the Big Three U.S. car producers suffered much higher drop in sales because they simply could not satisfy the changed market needs. In fact, their efforts to sell out the stocked SUVs made the situation even worse. As a result, all three companies ran out of cash at the end of 2008 and their continued operations were secured only thanks to government loans. GM alone received almost USD 40 billion at

[126] SHERK, J. *UAW Workers Actually Cost the Big Three Automakers $70 an Hour.* The Heritage Foundation, 8. 12. 2008.
[127] BRYCE, H. *Jobs bank programs – 12000 paid not to work*, The Detroit News, 17. 10. 2005.

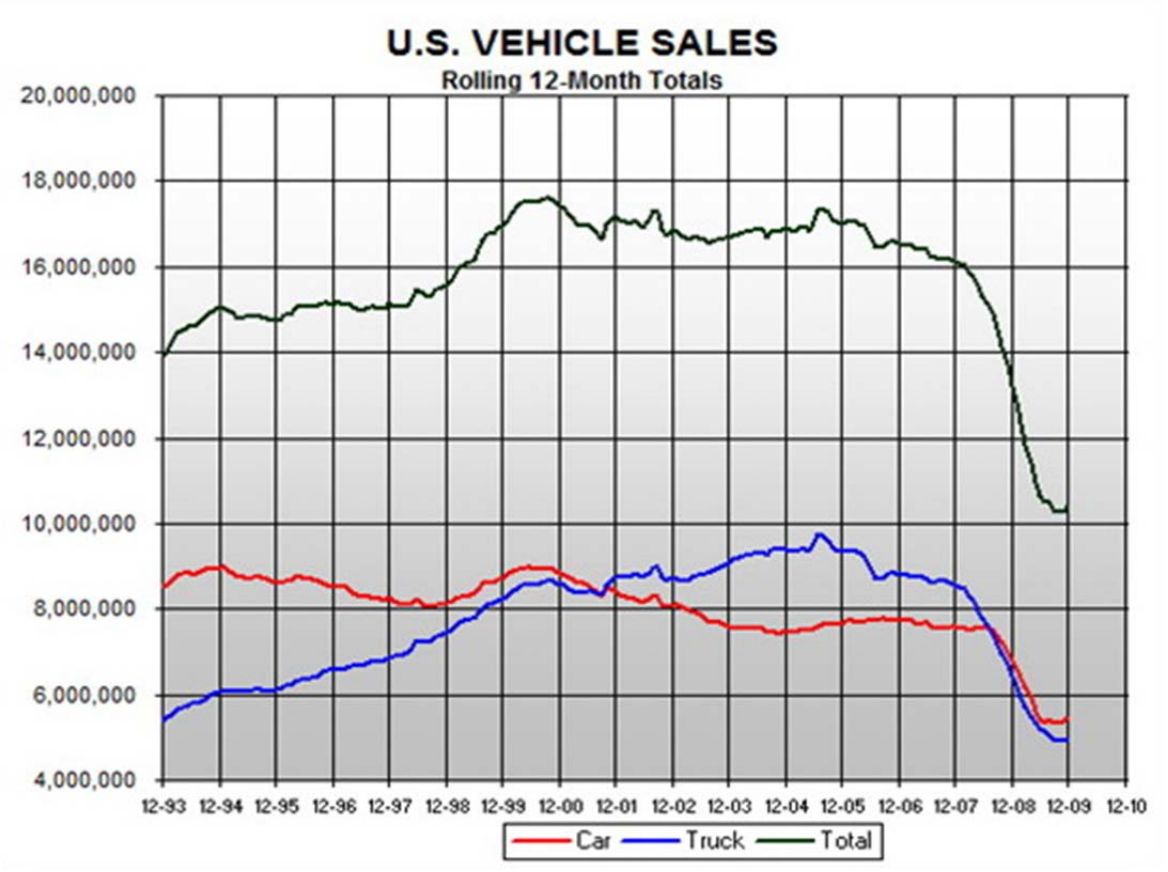
the beginning of 2009 but soon it turned out that the bankruptcy was inevitable. In the Graphs 4 and 5 below, the influence of key external factors can be seen.

Graph 4: Crude oil price development, 1998 - 2009



Source: EIA, available at www.whatmattersweblog.com

Graph 5: US vehicle sales development, 1994 - 2009



Source: NIEDERMEYER, P., available at www.thetruthaboutcars.com

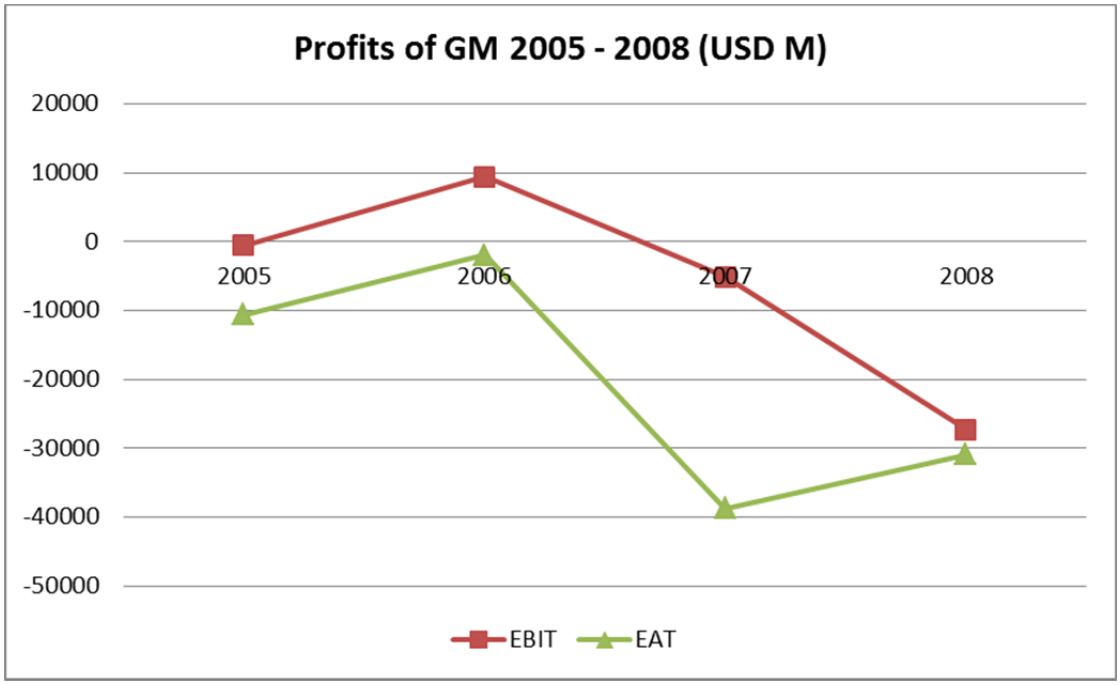
3) Competition from Asian manufacturers

The growing competition from Asian car manufacturers was another major cause of GM's decline. Already in 1980s, Japanese carmakers introduced several successful models into the U.S. market. Despite the initial suspicion of American consumers, Asian cars soon persuaded by their reliability, fuel efficiency and quality of service. In turn, GM started a new brand to market smaller cars, Saturn, but the sales results were not very convincing. In late 1990s, the position of Asian manufacturers was further strengthened as a result of the market entry of South Korean brands. With the growing competition, the margins in the small-size category shrank to some 3% and the Big Three producers turn to bigger cars which brought higher margins.

The orientation on SUV cars proved to be successful until mid-2000s when the fuel prices started to grow dramatically. In 2008, when the crude oil prices reached a ceiling, a gallon of petroleum cost over 4 dollars compared to 2 dollars just a couple years before. Many drivers could not afford to use their SUVs as often as before and started to carpool with their neighbors. Others were concerned about the climate change after the successful anti-global warming campaign, ran by a former presidential candidate, Albert Gore. As a result, the Big Three carmakers' U.S. market share dropped from 70% in 1998 to 53% in just ten years.

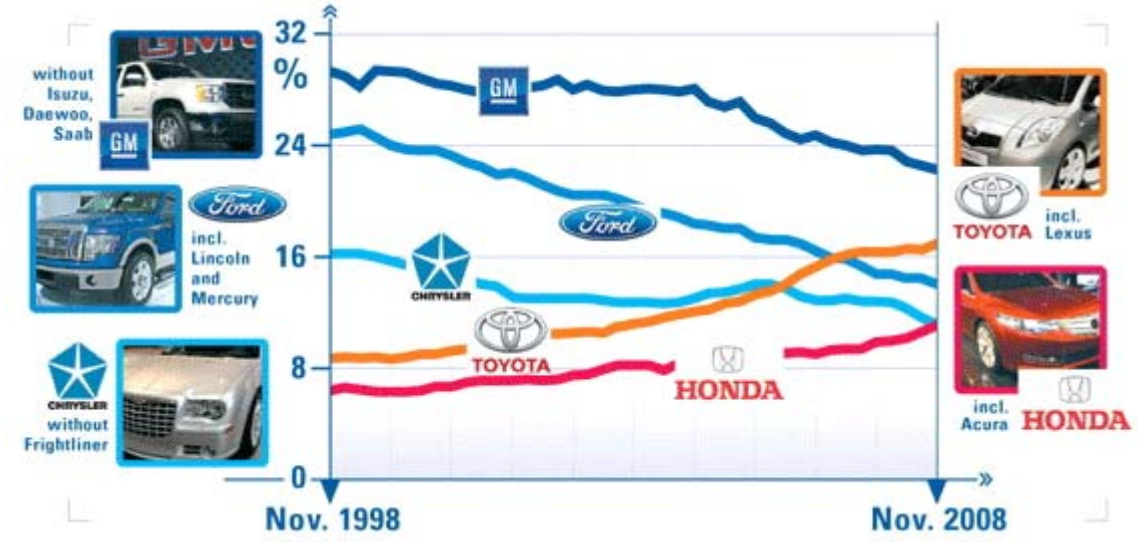
Several other factors affected the competitiveness of GM negatively. The company could not keep up with the innovation pace of Asian manufacturers and lacked their operational flexibility. While GM marketed eight different brands prior to 2009, Toyota had only three: Toyota, Lexus and Scion. Although a cut on the number of brands would help to decrease marketing costs, such a decision was very costly to implement. Only the discontinuation of Oldsmobile in 2004 cost GM USD 2 billion. Due to strict law on franchise business, even a business decision to close some of GM's dealerships would be linked with high termination fees.

Graph 6: Development of profits of GM 2005 - 2008



Source: Annual reports of GM, own work

Graph 7: Market share development of the 5 largest car sellers in the US 1998 - 2008



Source: The Wall Street Journal

5.3. Reorganization proceedings

The reorganization proceedings of the Old General Motors, effectuated from June to July 2009 hold several track records. It was the fourth largest bankruptcy in the U.S. history, the largest industrial bankruptcy in the history and one of the fastest pre-packaged reorganizations in the history, lasting just forty days. It cost the Federal Government exorbitant USD 50 billion in the bailouts provided to GM prior to the bankruptcy declaration. However, there is a good chance that the U.S. Treasury will break even after it sells off the remainder of its

controlling share in GM which it gained in a process not unlike nationalization in mid-2009.[128]

General Motors had been struggling with decreasing sales and growing losses long before the 2009 bankruptcy. The Big Three U.S. carmakers openly admitted their financial distress when the 2008 financial crisis started. In an attempt to help the companies recover and preserve the jobs in the industry, Bush administration provided short-term financing to the companies from the Troubled Asset Relief Program (TARP) funds at the end of 2008.[129] New Obama administration decided to continue the financial assistance after its start in January 2009 but is soon concluded that the short-term loans could not resolve the problem. First, GM was asked to rework its December 2, 2008 Restructuring Plan for Long-Term Viability. However, the 2009 – 2014 Restructuring Plan of February 17, 2009 failed to meet the Government's expectations to justify a new investment of taxpayer resources.[130] In turn, the Government decided to prepare a detailed plan of Chapter 11 bankruptcy reorganization for Chrysler and GM and extended credits to Ford whose financial position was least shaken.

Following the Chrysler bankruptcy petition filed on April 30, 2009, the General Motors Corporation entered the bankruptcy reorganization under Chapter 11 on June 1, 2009. At that time of the filing, GM was a publicly-owned company and had over USD 172 billion in debts, while its assets amounted to USD 82 billion. A smaller part comprised secured debts: GM owed USD 19.4 in pre-petition debt to the U.S. Treasury pursuant to the financial assistance from TARP, USD 3.9 billion to a syndicate of lenders led by Citicorp US, Inc. and USD 1.5 billion to a syndicate led by JP Morgan Chase. Smaller secured claims belonged to Export Development Bank Canada or Gelco Corporation. A greater part of the GM debts, a total of USD 117 billion was held in unsecured claims: the UAW Trust which was the major cause of the company's financial distress had a USD 21 billion claims against GM, USD 27 billion were owed in outstanding bonds. After the initiation of the reorganization proceedings, GM as a debtor-in-possession received another USD 30.1 billion loan from the U.S. Treasury and USD 9.2 billion from the Canadian Government.[131]

The key part of the reorganization plan was the creation of a new entity, Vehicle Acquisition Holdings LLC (referred to as "New GM") which purchased the operating assets of Old GM

[128] MERCED, M. *U.S. Taxpayers Recover Billions in Sale of G.M. Stock*. The New York Times, 17. 11. 2010.
[129] WARBURTON, J. *Understanding the Bankruptcies of Chrysler and General Motors: A Primer.*
[130] White House, *GM February 17 Plan Viability Determination*. 30. 3. 2009.
[131] WARBURTON, J. *Understanding the Bankruptcies of Chrysler and General Motors: A Primer.*

and assumed part of its pre-bankruptcy liabilities. Subsequently, the stock of New GM was distributed among the biggest creditors: Old GM received 10% in exchange for the asset transfer; the U.S. Treasury received 60.8% of its common stock, USD 2.1 billion of its preferred stock and a USD 6.7 billion note; Canadian Government received 12% of its common stock, USD 400 million of its preferred stock and a USD 1.3 billion note. As regards to the other creditors of Old GM, the first-priority secured lenders were repaid their USD 6 billion in full by New GM; the unsecured lenders received the 10% stake in New GM; shareholders received nothing.[132]

Many criticized the wipe-out of the Old GM shareholders effectuated by the section 363 sale but New GM did not need to ask them for permission. On the contrary, New GM needed to persuade the existing employees unionized under UAW to accept concessions on employee compensation, benefits and retiree healthcare. In a collective bargaining agreement with New GM, the UAW ultimately agreed to accept 17.5% share in New GM, USD 6.5 billion of its preferred stock and USD 2.5 billion note in favor of the UAW Trust.

So far, the plan seemed to be quite clear and straightforward: the working part of the Old GM will be transferred to New GM, creditors will receive satisfaction in the form of New GM stock and Old GM will be liquidated. However, the true controversy came with the sale effectuated pursuant to the Chapter 11 section 363. In Chapter 11 bankruptcy reorganization, there are two procedures available how to sell debtor's assets. In a standard sale pursuant section 1129, the debtor is required to draft a complete plan of reorganization, issue a disclosure statement and have the creditors voted for and the court confirmed the sale. It can be a lengthy and expensive process opposing the interest in a fast effectuation of the reorganization proceedings. The sale pursuant to section 363, on the other hand, can be done quickly, requiring only the approval of the bankruptcy court and it allows the debtor to sell his assets "free and clear" of all liens, thus securing a higher yield.[133]

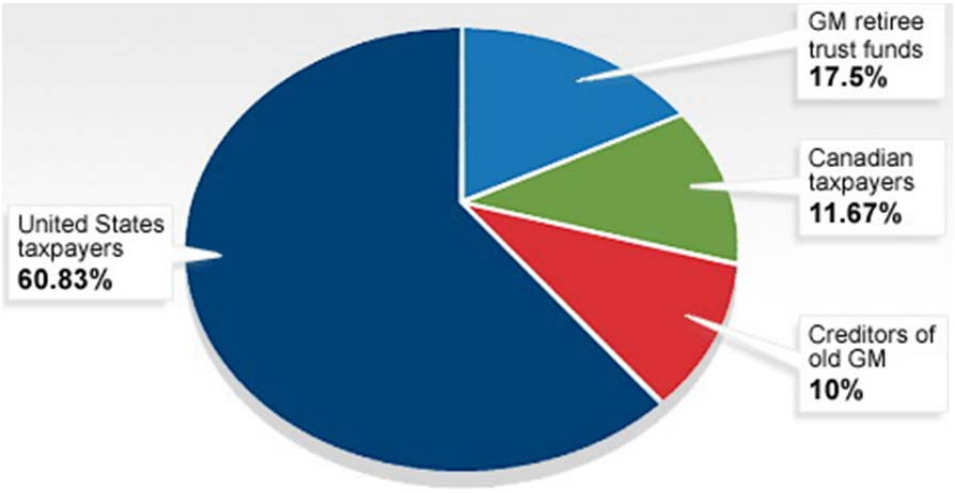
The intended purpose of section 363 was to allow a quick sale of a part of company's assets, but not the entire estate. The safeguards embodied in the section 1129 should have guaranteed that the formal plan of reorganization would not be bypassed and that the creditors would not be deprived of their voting rights. In practice, the section 363 sale became increasingly popular in late 1990s. In the past, however, courts sometimes declined such sales in that they

[132] Id.
[133] Id.

short-circuit the section 1129 requirements. Such sales were referred to as "sub rosa plans". Several precedents were available in favor of either of these sale methods.[134] Therefore it was ultimately up to the court if it will approve the 363 sale in case of GM.

For practical purposes, both the Chrysler and GM cases were tried by the U.S. Bankruptcy Court for the Southern District of New York, judge Robert Gerber was assigned the GM case. In deciding on the admissibility of the sale, the Court applied the so called Lionel test, which required an articulated business justification for the sale outside of the ordinary course of business.[135] The Court found that there was a sufficient business justification for the 363 sale because it allowed for the preservation of the going concern value facing the threat of liquidation. The 363 sale also secured a higher yield compared to what Old GM would receive in liquidation. There were several minority-shareholders' objections filed to the Court but it declined all of them, contending that the sale would not alter creditor priorities, thus not constituting a sub rosa plan.[136] Following the Court's decision, Old GM sold the majority of its assets to New GM on July 5, 2009 and was renamed as Motor Liquidation Company. New GM emerged from the reorganization just a few days later on July 10 as General Motors Company LLC.[137]

Graph 8: The ownership of the New GM



Source: ANDERSON, G., available at www.independentsentinel.com

[134] In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983), In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983).
[135] In re Lionel Corp., 722 F.2d 1063 (2d Cir. 1983).
[136] *In re General Motors Corp.*, 407 B.R. 463.
[137] WARBURTON, J. *Understanding the Bankruptcies of Chrysler and General Motors: A Primer.*

- **Timeline of the reorganization**[138]

- **Dec 2, 2008** - GM sought government aid of up to USD 18 billion pursuant to the filing of their "Restructuring Plan for Long-Term Viability".
- **Dec 19, 2008** - Chrysler and General Motors were granted USD 17.4 billion in government loans.
- **Jan 21, 2009** - Toyota surpassed General Motors as the world's largest carmaker for the first time in the history.
- **Feb 5, 2009** - GM announced a plan to cut their global salaried workforce by about 10,000.
- **Feb 17, 2009** – Following their "2009 – 2014 Restructuring Plan", GM raised another US funding request to a total of USD 30 billion, and announced plans to cut global workforce by 47,000 and close five U.S. plants by 2012.
- **Feb 26, 2009** – GM posted 2008 loss of USD 30.9 billion.
- **March 5, 2009** - Company's auditors raised "substantial doubt" about its ability to survive outside bankruptcy.
- **March 30, 2009** - Chief executive Rick Wagoner was dismissed by US Government and replaced by chief operating officer Fritz Henderson.
- **April 27, 2009** – GM offered final plan to reorganize outside bankruptcy by slashing bond debt, cutting over 21,000 more US jobs and emerging as a nationalized carmaker.
- **May 7, 2009** – GM posted a first-quarter net loss of USD 6 billion and a cash burn of USD 10.2 billion.
- **May 15, 2009** – GM unveiled plans to drop 1,100 of its smaller, less-profitable dealerships.
- **May 21, 2009** – GM announced a new cost-saving labor agreement with the UAW, under which UAW-aligned healthcare trust would receive half of the USD 20 billion debt GM owed the fund in the form of stock and new debt, instead of cash.
- **May 22, 2009** – GM borrowed another USD 4 billion from the U.S. Treasury and reached deal with Canadian auto workers.
- **May 27, 2009** - GM's offer to exchange USD 27 billion in bond debt for a 10%stake in a reorganized company failed.

[138] General Motors: timeline of the thrills and spills 1908-2011, The Telegraph, 5. 5. 2011, available at www.telegraph.co.uk/finance/newsbysector/transport/general-motors/8141256/General-Motors-timeline-of-the-thrills-and-spills-1908-2011.html.

- **May 28, 2009** - US Treasury and General Motors made new equity exchange offer under which bondholders would be offered 10% of a reorganized company and given warrants to purchase another 15%.
- **June 1, 2009** – General Motors Corporation filed for Chapter 11 bankruptcy protection.
- **July 10, 2009** – GM emerged from bankruptcy as General Motors Company with four core brands and majority owned by the US Government.
- **February 2010** - Spyker cars shareholders approved deal to acquire Saab from GM.
- **April 21, 2010** - Whitacre said IPO is "real possibility" by the end of 2010.
- **May 17, 2010** - GM said it has a "good chance" to report its first full-year profit since 2004.
- **June 16, 2010** - Company said it would restructure Opel without European aid after government talks get bogged down.
- **July 22, 2010** - GM announced USD 3.5 billion deal for AmeriCredit.
- **August 5, 2010** – CEO Ed Whitacre said GM was readying IPO documents.
- **August 12, 2010** - Whitacre said he would step down as chief executive and chairman. Board member Dan Akerson, 61, was named to succeed him.
- **November 18, 2010** - General Motors returned to the stock market in the biggest IPO in Wall Street history, following a final day of orders for GM shares with seven times more buyers than shares on offer. GM increased the number on shares on offer and raised the price from USD 26 to USD 33 a share, raising USD 20.1 billion. It has the option to sell up to USD 23.1 billion, which would eclipse Agricultural Bank of China as the biggest flotation in history.
- **February 1, 2011** - General Motors said their US sales rose by 22% in January, topping analysts' estimates, as deliveries of small sport-utility vehicles and other new models gained.
- **February 24, 2011** - General Motors hands 45,000 of its hourly US workers an average bonus of USD 4,300 after the country's biggest car maker roared back to profit.

5.4. Role of the courts and Government

The role of the Federal Government in the General Motors bankruptcy resolution was probably bigger than in any bankruptcy proceedings before. From the beginning of the U.S. automotive industry crisis, the Bush administration demonstrated their willingness to support

the home manufacturers by granting them financial aid, which resulted in a USD 13.4 billion loan from the Troubled Asset Relief Program in December 2008.[139] President Obama initially favored the GM's request for additional governmental funding but in the March 30, 2009 GM Restructuring Plan Viability Determination, the Government expressed their concerns that the proposed measures were not sufficient to stabilize the company.[140] Soon it became clear that the only acceptable alternative was Chapter 11 bankruptcy reorganization.

In the reorganization proceedings, the U.S. Treasury provided the company with another USD 30 billion debtor-in-possession loan in exchange for a 61% share of the newly founded entity.[141] Thus, the Government practically bought a majority share of the New GM for the total of USD 50 billion. In turn, some people named the company "Governmental Motors" because the state-sponsored bailout had a little public support.[142] However, it has never been the plan of Obama administration to control the company. From the beginning, they declared that after the necessary restructuring operations they would sell off the government share in an IPO. And so did it happen. On November 9, 2010, the Treasury offered 34% out of their 61% share of the New GM and thanks to the interest of investors it was recorded as the biggest initial public offering in the history, bringing the Government a USD 23.1 billion yield at 33 dollars per share. In order for the Government to break even and cover the USD 50 billion bailout costs (a USD 6.7 billion loan was already paid back), the remaining 27% share would have to be sold at 53 dollars per share.[143] Given the current stock price of 22 dollars per share, the sale cannot be expected in the near future.

5.5. Conclusions

Despite the many controversies and criticism of exorbitant state expenses over the time of financial crisis, the reorganization of General Motors can be considered a successful one. President Obama's administration did a small miracle in that they effectuated both the reorganizations of Chrysler and GM in less than two months. Given that yet in March 2009, GM strongly opposed the idea of bankruptcy, and in mid-July, the whole process was over, the Federal Government and the New York bankruptcy court certainly earned their credit.

From the economic perspective, the reorganization can be viewed positively, too. First, the going concern value of the company was preserved and second, the reorganization

[139] WARBURTON, J. *Understanding the Bankruptcies of Chrysler and General Motors: A Primer.*
[140] White House, *GM February 17 Plan Viability Determination*. 30. 3. 2009.
[141] WARBURTON, J. *Understanding the Bankruptcies of Chrysler and General Motors: A Primer.*
[142] MERCED, M. *U.S. Taxpayers Recover Billions in Sale of G.M. Stock*. The New York Times, 17. 11. 2010.
[143] Id.

proceedings were done at very low costs thanks to the swiftness of the process. Already the fact that the bankruptcy judge managed to cope with 850 objections against the 363 sale of GM's assets is stunning. To be fair, the fast pace of the proceedings should be rather attributed to the political pressure. As a sponsor of the reorganization, the Government most likely would not support the lengthy 1129 sale.[144]

First positive signs of a business recovery can be seen. In 2010, GM reported a sound profit of USD 4.7 billion and the positive trend continues. In the first two quarters of 2011, GM earned sound USD 5.7 billion. At the same time, GM significantly reduced their break-even point. While they incurred a USD 38 billion loss in 2007 at 3.8 million sold cars, in 2010, they posted profits having sold 2.2 million.[145] It seems clear that the company learned how to make money on compact cars that used to be considered loss-leaders before. Customers started to appreciate the better compact cars too. Their relative sales doubled over the last decade and the market share of the U.S. models is steadily growing. Considering the fuel savings attributable to the compact cars, it seems that the bankruptcies were worth it.

Several questions remain open for the future. First, will the restructured carmakers withstand the revived competition from their Asian rivals? While the Big Three was facing their own troubles, Japanese and Korean manufacturers did not have to exert any special efforts but that can change quickly as they are well known for their large innovative capacity. The fact that the labor costs of the Big Three have come closer to those of Toyota and Honda will not suffice alone. What is more, the UAW can be expected to bargain very energetically for some rise given the concessions they made earlier. Second, will the consumers regain trust in the U.S. carmakers fast enough? It is a well-known fact that it takes much longer to build trust than to lose it. And third, will the global economy finally recover from the financial and debt crises of the recent years? That is more a question for a prophet than for a business analyst.

[144] MAYNARD, M. *Automakers' Swift Cases in Bankruptcy Shock Experts*. The New York Times, 6. 7. 2009.
[145] BUNKLEY, N. Vlasic, B. *General Motors Files for an Initial Public Offering*. The New York Times, 19. 8. 2010.

6. Comparison of the Reorganizations

The reorganization proceedings of Kordárna and General Motors are seemingly incomparable. But same as in the case of the Czech and U.S. insolvency legal framework, there can be some interesting similarities found between the two cases.

6.1. Common characteristics

The most obvious link between the two cases is the method how the reorganizations were effectuated. Both in case of Kordárna and GM, a new entity was founded which assumed part of assets and liabilities of the original firm. Assets which were not needed any more were left to the old company and liquidated. The new companies, clear of their earlier burdens thus became more attractive for investors. Creditors were satisfied from the yield of the sales according to their priority. But while Kordárna Plus was sold as a whole to one buyer, the General Motors Company, then controlled by the U.S. Government, was offered in an IPO at a stock exchange.

Another common characteristic was the professionalism and expertise of the bankruptcy courts that significantly contributed to the fast and smooth run of the proceedings. Interesting is that both companies had an influence on the selection of the court. While the insolvency proceedings of Kordárna really belonged under the competence of the Regional Court in Brno, cases of the other three companies from Kord Group would be normally tried elsewhere. However, thanks to the institute of the Center of the Main Interest, the Court in Brno assumed all four proceedings. A similar strategy how to get under the jurisdiction of the Bankruptcy Court for the Southern District of New York was used by GM: first, one of their fully-owned dealerships in Manhattan filed a petition for bankruptcy which allowed GM to file their case in New York too.[146]

Finally, the most important similarity of the reorganizations was their successful outcome in both cases. Shortly after the creation of the new entity, Kordárna Plus started to generate positive cash flow and was able to continue its operations without further external funding. The turnaround in the GM case was logically much more complicated because deep structural changes and strategic decisions including production plant and dealership closings had to be

[146] WARBURTON, J. *Understanding the Bankruptcies of Chrysler and General Motors: A Primer.*

made. Nevertheless, the project proved its viability and since the first quarter of 2010, GM started generating profits for the first time in five years.[147]

Table 12: Comparison of the reorganization proceedings of Kordárna and GM

	Kordárna	General Motors
Duration	1 year	40 days
Debt at the moment of bankruptcy	CZK 2.2 billion	USD 172 billion
Assets at the moment of bankruptcy	CZK 3.25 billion	USD 82 billion
Debt-to-equity ratio	68%	210%
Reorganization method	Sale of part of assets in a public auction, liquidation of the rest	Sale in a pre-packaged reorganization, liquidation
Reorganization financing	Results of own operations	Debtor-in-possession financing from the Federal Government
Recovery rate	15% secured/8% unsecured	100% secured/10% stake in New GM pro rata for unsecured

Source: Annual reports of Kordárna and GM, isir.justice.cz, www.motorsliquidationdocket.com, own work

6.2. Major differences

Still, the differences prevail. Although both companies found themselves in insolvency prior to the filing of the petition for bankruptcy, the debts of GM were triple relative to those of Kordárna. Further, the reorganization proceedings in case of GM lasted only a short while compared to those of Kordárna. Because GM already filed their petition along with the plan of reorganization, the court treated the case as the so called pre-packaged reorganization. Unlike Kordárna, GM was far from able to finance the reorganization from their own funds. They received government support amounting to almost one-third of their existing debt. And most importantly, the role of the national Governments in both cases was totally different. While GM was a typical example of a too-big-to-fail company same as Chrysler and Ford, Kordárna did not play a major role in the Czech economy. While the liquidation of GM would bring about loss of millions of jobs, Kordárna and its suppliers employed only hundreds.

6.3. Comparison of financial performance

For a closer comparison of the financial performance of both reorganized companies, a more detailed look at the business results preceding the declaration of bankruptcy is necessary. The table 13 below records the development from 2006 to 2010.

[147] Annual reports of Kordárna and GM.

Table 13: Comparison of financial performance of Kordárna and GM over time

	Kordárna (CZK in millions)				General Motors (USD in millions)			
	2005	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**
Revenue	3079	2958	3141	2496	192604	207349	181122	148979
EBIT	284	255	324	-90	-568	9461	-5111	-27281
EAT	176	143	187	-181	-10567	-1978	-38732	-30860
Profit margin	5.70%	4.85%	5.94%	-7.24%	-5.49%	-0.95%	-21.38%	-20.71%
Assets	2985	3069	3162	3251	476078	186192	148883	91047
Equity	1289	1398	1442	1132	14598	-5441	-37094	-86154
Debt	1689	1640	1692	2080	461481	191633	185977	177201
ROA	5.88%	4.67%	5.90%	-5.56%	-2.22%	-1.06%	-26.02%	-33.89%
ROE	13.62%	10.26%	12.94%	-15.97%	-72.39%	-	-	-
D/A	0.57	0.53	0.54	0.64	0.97	1.03	1.25	1.95
D/E	1.31	1.17	1.17	1.84	31.61	-	-	-

Source: Annual reports of Kordárna and GM, own work

In the comparison of financial performance of the two companies, it can be clearly seen that while the financial situation of Kordárna appeared to be healthy until 2007 and then deteriorated quickly, the losses of General Motors accumulated gradually over time. Interestingly, the crisis progressed so far in GM that they reported stockholder deficits instead of equity as of 2006. In all respects, the results of Kordárna and GM are largely incomparable. Despite officially considered a large enterprise in the Czech Republic, Kordárna is more than thousand times smaller in terms of annual revenues.

6.4. Inspiration for the Czech law

Even though a similar case like the one of General Motors reorganization will probably never occur in the Czech Republic, it provides several important lessons. First of all, despite the relative proximity of the Czech and U.S. insolvency regulations, the different way how the law is being interpreted can seriously influence the outcome of court's decisions. Without the precedents on the 363 sale pursuant to USBC Chapter 11, the GM reorganization could have never been finished within such a short period. Czech courts do not have such a discretion power and have to rely on the quality and complexity of the legislators' work which reduced the flexibility of the law.

Further, reorganization in the Czech Republic is still viewed as a complicated and costly institute that can only rarely bring better results than straight bankruptcy. Of course, the absolute number of firms where reorganization could be even considered is much lower here but that does not mean that no one can use it. Every year, several large companies declare

insolvency in the Czech Republic and straight bankruptcy is still the preferred solution for them.

Last but not least, we should learn from the Americans how to make our insolvency proceedings run faster and in a more efficient way. The unfavorable statistics of low recovery rates and high costs of insolvency proceedings compared to those common in the U.S. raises an important question if we are doing enough. To be completely fair, we should wait for new statistics reflecting the effect of the 2006 Insolvency Act. Nevertheless, there is always some space for improvements and it is certainly worth to invest the efforts to promote the level of the Czech judiciary in the eyes of foreign investors.

Conclusion

Insolvency law is a fascinating discipline which may help people and businesses out of their financial distress if used cautiously and responsibly. On the other hand, it may also cause much harm if mistreated and misunderstood. Insolvency law, however, is not only about liquidating or rescuing bankrupt firms or individuals; it is also about re-creating values, implementing new ideas and making things work better. The reorganizations of Kordárna and General Motors are perfect examples of crises which had been resolved successfully thanks to the knowledge and expertise of those involved in the insolvency proceedings. Although very different in essence, the two cases have lot in common and can be well used as a model for future reorganizations.

With the new Insolvency Act introduced in 2006, the Czech insolvency law finally turned into a working system which can bring a desired relief from debts both to individuals and firms. Initially seen as a risky experiment, the adoption of some of the US Bankruptcy Code institutes ultimately proved to be a good idea. The growing number of debtors' bankruptcy petitions is a perfect example of how fast people learned to use the law in their favor. Among others, the institute of debt-relief has been getting increasingly popular in recent years and there is a good reason to believe that companies will consider bankruptcy reorganizations to a greater extent as well.

Many people think that in an ideal world, no insolvency law would have to exist. The author modestly disagrees. Everything has its beginning and its end and so do the businesses. Firms have a life-cycle similar to the one of their products – if they innovate, they continue to live but if they fail to innovate, they have to leave the market after some time. In some cases, however, it may be worth to give them one more chance. This natural circulation applies to people too in certain aspects. Of course, people do not die due to their debts but when filing for a debt-relief, they effectively leave their old lives with debts and start a new one, having learned from their mistakes, hopefully.

In cases of Kordárna and General Motors, the reorganization method of insolvency settlement turned out to be successful for several reasons. Both companies had a solid positive going-concern-value prior to the declaration of bankruptcy; both had some sort of sustainable competitive advantage; both were able to restructure their businesses to cut costs and increase the efficiency of production. But most importantly, Kordárna as well as General Motors took their insolvencies as a unique opportunity to separate from their past and invest into research

and development to enhance their future competitiveness. Finally, they both relied on the right people who led them through the insolvency proceedings as fast and smoothly as possible.

To conclude, insolvency law may help companies become more efficient and profitable same as it may help individuals to behave carefully and to become aware of their own limits. Therefore, it should not be viewed as something bad or shameful – it is an inherent part of our lives. Understanding the insolvency law and its principles can be useful for everyone, not only for insolvency lawyers. When conscious of the causes of insolvency, we may easier avoid one. And especially in case of business corporations, the knowledge of its basic may be the factor distinguishing the successful ones from those that fail.

Translations of terms used in the work

- Insolvency = platební neschopnost, insolvence
- Bankruptcy = úpadek
- Straight bankruptcy = konkurs
- Composition = vyrovnání
- Reorganization = reorganizace
- Debt-relief = oddlužení
- Petition for bankruptcy = insolvenční návrh
- Declaration of bankruptcy = prohlášení úpadku
- Motion for approval of reorganization = návrh na povolení reorganizace
- Plan of reorganization = reorganizační plán
- Accomplishment of the plan of reorganization = splnění reorganizačního plánu
- Creditors' meeting = schůze věřitelů
- Creditors' committee = věřitelský výbor
- Insolvency trustee = insolvenční správce
- Debtor-in-possession = dlužník s dispozičními právy
- Security = jistota
- Collateral = zajištění

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Appendices

Appendix 1: Profit and Loss Statement 2005 - 2008, Kordárna, a.s.

	(CZK in thousands)	2005	2006	2007	2008
I.	Revenues from merchandise	56 101	70 979	47 805	249 046
A.	Expenses on sold goods	48 735	64 978	46 088	247 803
+	Sale margin	7 366	6 001	1 717	1 243
II.	Production	3 121 332	2 956 430	3 168 625	2 459 403
1.	Revenues from own products and services	3 079 243	2 958 007	3 140 990	2 496 427
2.	Change in inventory of own production	37 887	-11 702	24 302	-40 100
3.	Capitalization	4 202	10 125	3 333	3 076
B.	Production consumption	2 553 166	2 432 309	2 614 042	2 222 728
1.	Consumption of material and energy	2 260 129	2 157 894	2 335 174	1 982 994
2.	Services	293 037	274 415	278 868	239 734
+	Added value	575 532	530 122	556 300	237 918
C.	Personnel expenses	176 457	186 430	203 579	205 427
1.	Wages and salaries	127 711	134 626	147 494	148 572
2.	Remuneration of board members	840	840	840	840
3.	Social security expenses	44 606	46 916	51 563	51 756
4.	Social expenses	3 300	4 048	3 682	4 259
D.	Taxes and fees	2 732	2 379	2 454	565
E.	Depr. of intangible & tangible fixed property	127 625	122 948	125 912	130 901
III.	Revenues from sale of fixed property & mat.	1 159 524	1 117 301	1 143 527	1 130 205
F.	Net book value of sold fixed property & mat.	1 180 120	1 128 014	1 108 291	1 039 677
G.	Accounting for adjustments to op. expenses	-18 390	-10 808	-11 529	19 535
IV.	Other operating revenues	607 375	734 981	993 906	518 050
H.	Other operating expenses	625 606	746 456	1 011 116	532 898
*	Operating profit (loss)	248 281	206 985	253 910	-42 830
VII.1	Revenues from fixed financial property	0	0	0	22 400
X.	Received interests	8 704	9 368	9 376	17 710
N.	Paid interests	47 845	63 420	85 689	87 189
XI.	Other financial revenues	158 575	157 106	236 709	530 981
O.	Other financial expenses	131 371	118 208	176 382	618 093
*	Income from financial operations	-11 937	-15 154	-15 986	-134 191
S.	Income tax on current activity	60 774	48 361	51 377	3 815
**	Ordinary income	175 570	143 470	186 547	-180 836
***	EAT = Profit of current accounting period	175 570	143 470	186 547	-180 836
U	EBT = Profit before tax	236 344	191 831	237 924	-177 021
****	EBIT= Profit before interest and tax	284 189	255 251	323 613	-89 832

Source: Kordárna, Annual report 2008

Appendix 2: Balance Sheet: Assets 2005 – 2008, Kordárna, a.s.

	(CZK in thousands)	2005	2006	2007	2008
	TOTAL ASSETS	2 985 859	3 069 121	3 162 368	3 251 312
A.	Stock Subscription Receivable	0	0	0	0
B.	Fixed assets	1 833 105	2 104 507	2 057 559	1 960 847
B.I.	Intangible assets	52 617	90 369	94 656	90 357
3.	Software	8 034	15 767	36 425	24 293
5.	Other intangible assets	1 215	734	512	336
7.	Intangible assets in progress	41 015	71 515	55 366	65 728
8.	Advances granted for intangible assets	2 353	2 353	2 353	0
B.II.	Tangible assets	1 250 681	1 518 412	1 561 855	1 482 497
1.	Land	16 972	16 611	16 608	16 477
2.	Constructions	442 169	466 691	636 643	648 685
3.	Separate chattels and groups of chattel	499 880	538 618	672 268	690 018
6.	Other tangible assets	240	240	211	211
7.	Tangible assets in progress	235 314	445 524	227 550	125 812
8.	Advances granted for tangible assets	56 106	50 728	8 575	1 294
B.III.	Financial investments	529 807	495 726	401 048	387 993
1.	Subsidiaries	498 699	442 551	346 778	315 642
2.	Associates	31 108	53 024	53 647	72 166
6.	Long-term investment in progress	0	151	623	185
C.	Current assets	1 148 533	941 171	1 086 753	1 278 447
C.I.	Inventory	352 769	299 277	301 045	208 977
1.	Materials	67 119	63 908	70 442	27 738
2.	Work-in-progress and semi-finished p.	129 632	109 930	119 952	62 372
3.	Finished products	99 114	104 252	106 760	117 876
5.	Goods	22 445	13 458	2 077	990
6.	Advances granted for inventory	34 459	7 729	1 814	1
C.II.	Long-term receivables	84 328	68 994	0	0
2.	R. to group firms with majority control	84 328	68 994	0	0
C.III.	Short-term receivables	689 447	515 428	744 051	1 054 125
1.	Trade receivables	443 040	354 210	413 657	569 840
2.	R. within the concern	227 230	133 393	304 527	433 307
6.	Due from government – tax receivables	13 715	21 874	19 598	42 213
7.	Short-term advances granted	5 327	5 818	6 135	8 765
8.	Estimated receivables	0	0	1	0
9.	Other receivables	135	133	133	0
C.IV.	Short-term financial assets	21 989	57 472	41 657	15 345
1.	Cash	96	74	64	44
2.	Bank accounts	21 893	57 398	41 593	15 301
D.I.	Temporary accounts of assets	4 221	23 443	18 056	12 018
1.	Prepaid expenses	2 405	22 109	17 069	11 870
2.	Unbilled revenues	1 816	1 334	987	148

Source: Kordárna, Annual report 2008

Appendix 3: Balance Sheet: Liabilities 2005 – 2008, Kordárna, a.s.

	(CZK in thousands)	2005	2006	2007	2008
	TOTAL LIABILITIES	2 985 859	3 069 121	3 162 368	3 251 312
A.	Equity	1 288 816	1 397 681	1 441 697	1 132 307
A.I.	Basic capital	562 197	562 197	562 197	562 197
1.	Basic capital	562 197	562 197	562 197	562 197
A.II.	Capital funds	-187 819	-222 424	-364 956	-493 509
2.	Other capital funds	23 717	23 717	23 717	23 717
3.	Differences from revaluation of assets and l.	-211 536	-246 141	-388 673	-517 226
A.III.	Reserve funds and other funds created from p.	94 578	103 356	110 530	112 439
1.	Legal reserve fund	94 578	103 356	110 530	112 439
A.IV.	Profit (loss) for the previous years	544 290	811 082	947 379	1 132 016
1.	Retained earnings from previous years	544 290	811 082	947 379	1 132 016
A.V.	Profit (loss) for the year	175 570	143 470	186 547	-180 836
B.	Liabilities	1 688 722	1 639 967	1 692 196	2 079 840
B.I.	Reserves	18 129	0	0	0
B.II.	Long-term liabilities	54 160	60 600	64 641	68 258
10.	Deferred tax liability	54 160	60 600	64 641	68 258
B.III.	Short-term liabilities	432 205	342 092	368 429	761 163
1.	Trade payables	418 384	327 080	336 867	478 571
2.	L. to group firms with majority control	0	1 529	2 116	690
5.	Liabilities to employees	8 208	8 465	9 477	9 254
6.	L. from social security & health insurance	3 957	3 916	4 775	4 053
7.	Due to government – taxes and subsidies	947	773	1 048	749
8.	Advances received	88	49	2 007	645
10.	Unbilled deliveries	252	142	444	447
11.	Other liabilities	369	138	11 695	266 754
B.IV.	Bank loans and borrowings	1 184 228	1 237 275	1 259 126	1 250 419
1.	Long-term bank loans	475 015	888 089	678 810	503 591
2.	Short-term bank loans	709 213	349 186	580 316	746 828
C.I.	Temporary accounts of liabilities	8 321	31 473	28 475	39 165
1.	Accruals	8 321	9 916	6 951	25 086
2.	Deferred income	0	21 557	21 524	14 079

Source: Kordárna, Annual report 2008

Appendix 4: Income statement 2006 – 2010, General Motors Company

GENERAL MOTORS COMPANY AND SUBSIDIARIES

(Dollars in millions except per share amounts)

	Successor		Predecessor			
	Year Ended December 31, 2010 (a)	July 10, 2009 Through December 31, 2009 (a)(b)	January 1, 2009 Through July 9, 2009	Years Ended December 31, 2008	2007	2006
Income Statement Data:						
Total net sales and revenue (c)(d)	$135,592	$ 57,474	$ 47,115	$148,979	$179,984	$204,467
Reorganization gains, net (e)	$ —	$ —	$128,155	$ —	$ —	$ —
Income (loss) from continuing operations (e)(f)	$ 6,503	$ (3,786)	$109,003	$ (31,051)	$ (42,685)	$ (2,155)
Income from discontinued operations, net of tax (g)	—	—	—	—	256	445
Gain on sale of discontinued operations, net of tax (g)	—	—	—	—	4,293	—
Net income (loss) (e)	6,503	(3,786)	109,003	(31,051)	(38,136)	(1,710)
Net (income) loss attributable to noncontrolling interests	(331)	(511)	115	108	(406)	(324)
Less: Cumulative dividends on and charge related to purchase of preferred stock (h)	1,504	131	—	—	—	—
Net income (loss) attributable to common stockholders (e)	$ 4,668	$ (4,428)	$109,118	$ (30,943)	$ (38,542)	$ (2,034)
GM $0.01 par value common stock and Old GM $1-2/3 par value common stock						
Basic earnings (loss) per share:						
Income (loss) from continuing operations attributable to common stockholders	$ 3.11	$ (3.58)	$ 178.63	$ (53.47)	$ (76.16)	$ (4.39)
Income from discontinued operations attributable to common stockholders (g)	—	—	—	—	8.04	0.79
Net income (loss) attributable to common stockholders	$ 3.11	$ (3.58)	$ 178.63	$ (53.47)	$ (68.12)	$ (3.60)
Diluted earnings (loss) per share:						
Income (loss) from continuing operations attributable to common stockholders	$ 2.89	$ (3.58)	$ 178.55	$ (53.47)	$ (76.16)	$ (4.39)
Income from discontinued operations attributable to common stockholders (g)	—	—	—	—	8.04	0.79
Net income (loss) attributable to common stockholders	$ 2.89	$ (3.58)	$ 178.55	$ (53.47)	$ (68.12)	$ (3.60)
Cash dividends per common share	$ —	$ —	$ —	$ 0.50	$ 1.00	$ 1.00
Balance Sheet Data (as of period end):						
Total assets (d)(f)	$138,898	$136,295		$ 91,039	$148,846	$185,995
Automotive notes and loans payable (i)(j)	$ 4,630	$ 15,783		$ 45,938	$ 43,578	$ 47,476
GM Financial notes and loans payable (d)	$ 7,032					
Series A Preferred Stock (k)	$ 5,536	$ 6,998		$ —	$ —	$ —
Series B Preferred Stock (l)	$ 4,855	$ —		$ —	$ —	$ —
Equity (deficit) (f)(m)(n)	$ 37,159	$ 21,957		$ (85,076)	$ (35,152)	$ (4,076)

Source: GM, Annual report 2010

Appendix 5: Balance Sheet 2009 – 2010, General Motors Company

GENERAL MOTORS COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In millions, except share amounts)

	Successor	
	December 31, 2010	December 31, 2009
ASSETS		
Automotive Current Assets		
Cash and cash equivalents	$ 21,061	$ 22,679
Marketable securities	5,555	134
Total cash, cash equivalents and marketable securities	26,616	22,813
Restricted cash and marketable securities	1,240	13,917
Accounts and notes receivable (net of allowance of $252 and $250)	8,699	7,518
Inventories	12,125	10,107
Assets held for sale	—	388
Equipment on operating leases, net	2,568	2,727
Other current assets and deferred income taxes	1,805	1,777
Total current assets	53,053	59,247
Automotive Non-current Assets		
Restricted cash and marketable securities	1,160	1,489
Equity in net assets of nonconsolidated affiliates	8,529	7,936
Property, net	19,235	18,687
Goodwill	30,513	30,672
Intangible assets, net	11,882	14,547
Deferred income taxes	308	564
Assets held for sale	—	530
Other assets	3,286	2,623
Total non-current assets	74,913	77,048
Total Automotive Assets	127,966	136,295
GM Financial Assets		
Finance receivables (including finance receivables transferred to special purpose entities of $7,156 at December 31, 2010; Note 7)	8,197	—
Restricted cash	1,090	—
Goodwill	1,265	—
Other assets	380	—
Total GM Financial Assets	10,932	—
Total Assets	$138,898	$136,295
LIABILITIES AND EQUITY		
Automotive Current Liabilities		
Accounts payable (principally trade)	$ 21,497	$ 18,725
Short-term debt and current portion of long-term debt (including debt at GM Daewoo of $70 at December 31, 2010; Note 17)	1,616	10,221
Liabilities held for sale	—	355
Postretirement benefits other than pensions	625	846
Accrued liabilities (including derivative liabilities at GM Daewoo of $111 at December 31, 2010; Note 17)	23,419	22,288
Total current liabilities	47,157	52,435
Automotive Non-current Liabilities		
Long-term debt (including debt at GM Daewoo of $835 at December 31, 2010; Note 17)	3,014	5,562
Liabilities held for sale	—	270
Postretirement benefits other than pensions	9,294	8,708
Pensions	21,894	27,086
Other liabilities and deferred income taxes	13,021	13,279
Total non-current liabilities	47,223	54,905
Total Automotive Liabilities	94,380	107,340
GM Financial Liabilities		
Securitization notes payable (Note 19)	6,128	—
Credit facilities	832	—
Other liabilities	399	—
Total GM Financial Liabilities	7,359	—
Total Liabilities	101,739	107,340
Commitments and contingencies (Note 22)		
Preferred stock Series A, $0.01 par value (2,000,000,000 shares authorized and 360,000,000 shares issued and outstanding (each with a $25.00 liquidation preference) at December 31, 2009)	—	6,998
Equity		
Preferred stock, $0.01 par value, 2,000,000,000 shares authorized:		
Series A (276,101,695 shares issued and outstanding (each with a $25.00 liquidation preference) at December 31, 2010)	5,536	—
Series B (100,000,000 shares issued and outstanding (each with a $50.00 liquidation preference) at December 31, 2010)	4,855	—
Common stock, $0.01 par value (5,000,000,000 shares authorized and 1,500,136,998 shares and 1,500,000,000 shares issued and outstanding at December 31, 2010 and 2009)	15	15
Capital surplus (principally additional paid-in capital)	24,257	24,040
Retained earnings (accumulated deficit)	266	(4,394)
Accumulated other comprehensive income	1,251	1,588
Total stockholders' equity	36,180	21,249
Noncontrolling interests	979	708
Total equity	37,159	21,957
Total Liabilities and Equity	$138,898	$136,295

Source: GM, Annual report 2010