

## **Bankruptcy Trustee in Insolvency Proceedings as an Entrepreneur and as a Subject of the Proceeding**

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### **Abstract**

*The article deals with the position and activities of bankruptcy trustee in bankruptcy proceeding, restructuring proceeding and in proceeding on debt relief. These proceedings are being called insolvency proceedings. The paper brings a closer look on conditions of trustee's activity and his/her activities in various types and stages of insolvency proceedings. The authors analyze the fact whether trustee's activity meets all attributes of enterprising.*

### **Key words**

*Trustee, bankruptcy proceeding, restructuring proceeding, debt relief proceeding, position of trustee, trustee's activity*

**JEL Classification:** K35

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### **Introduction**

Insolvency law is an important part of the Slovak legal regulation with Act No. 7/2005 of the Coll. on Bankruptcy and Restructuring and on Changes and Amendments of Certain Acts in Wording of Changes and Amendments (thereinafter only as "act on bankruptcy and restructuring" or "ZKR") as it is a basic source that entered into force on 1st of January 2006 and substituted the Act No. 328/1991 of the Coll. on Bankruptcy and Settlement that was valid at our territory since 1st of October 1991 till 31st of December 2005.

There are three insolvency proceedings regulated in act on bankruptcy and restructuring which consists of bankruptcy proceeding, restructuring proceeding and proceeding on debt relief. The keystone of these proceedings is the solution of insolvency of the debtor that is connected with the existence of claims of various creditors against one debtor who is not able to fulfil his/her payable obligations due to default (insolvency) or due to overdebteness. ZKR defines the insolvency in § 3 sec. 2 as a state when the debtor has more than one creditor and is therefore unable to satisfy more than one monetary obligation in a period of 30 days after its day of maturity. Overdebteness is defined in §3 sec 3 of the ZKR as state when the debtor has more than one creditor and the value of mature obligations overreaches the value of his assets discovered from accounting books. The overdebteness may be achieved only by the debtor obliged to keep accounting books according to special act.

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Bankruptcy proceeding is a liquidation judicial proceeding solving the insolvency of debtor by monetization of his assets and by collective satisfaction of the debtor's creditors. Bankruptcy proceeding must always take place before the proceeding on debt relief that has not liquidation character and its goal is to reach debt relief of the debtor - a natural person, no matter whether it is an entrepreneur (for instance a sole trader) or non-entrepreneur subject (for instance an employee). Restructuring proceeding is non-liquidation judicial proceeding that solves the insolvency or imminent insolvency of the debtor with the goal to achieve collective satisfaction of creditors by means agreed in the restructuring plan.

The trustee plays an important role in the process of the solution of debtor's insolvency. The position of trustees, their rights and obligations, responsibility, education as well as supervision over their activity is regulated in Act No. 8/2005 of the Coll. on Trustees and on Change and Amendments of Certain Acts (thereinafter only as "act on trustees" or "ZoS") that entered into force on 1st of July 2005. Activity of trustees is specified in act on bankruptcy and restructuring.

The aim of this paper is to bring the readers a closer look onto the activity of trustee in insolvency proceedings as well as his position resulting both from the regulation of the act on trustees and from the regulation of the bankruptcy and restructuring.

## **1 Conditions of performance of trustee's activity in insolvency proceedings**

Activity of trustee in insolvency proceedings, i.e. in an bankruptcy, restructuring and debt relief proceedings may be performed solely by the natural or legal person registered in the list of trustees. The Ministry of Justice of the Slovak Republic (thereinafter only as "Ministry") decides on registration in the list of trustees, keeps the list and upon request it registers in the list of trustees the candidate applying for registration who meets the criteria set by the act on trustees (§ 21-23 of ZoS). Principal emphasis is placed on these assumptions, the integrity, credibility and competence of the person being registered. The competent person is an individual who has completed a legal or economic education of second grade and proves its capability by successful passing the trustee's tests following the expert training. In case of artificial persons, the conditions required from natural persons must be met by the shareholders or members of statutory bodies. A Slovak artificial person applying for registration in the list of trustees must have the form of a public company or limited partnership (§ 22 of ZoS). For foreign artificial persons there is requirement for one or more shareholders to be responsible for obligations of the artificial person with all its assets (§ 23 of ZoS)

Among the assumptions required for performance of activities of trustee there is necessary to set up the office. This requirement exists because of the fact that in bankruptcy, restructuring and debt relief proceeding as a trustee there can be appointed only natural or artificial person registered in the list of trustees, which has an established office in the district of a regional court in which the bankruptcy (district) court resides.

## 2 Activity of the trustee in insolvency proceeding

Trustee's activities are challenging and varied. Their varieties are depending on the type of insolvency proceedings and also depending on their stage. In the bankruptcy proceeding the trustee may act as an interim trustee and also as a bankruptcy trustee. In the proceedings on debt relief he acts as trustee for debt relief and in restructuring proceedings restructuring trustee or supervisory trustee.

The main task of the interim trustee is to determine whether the debtor's assets will be sufficient enough to cover the costs of bankruptcy proceedings and shall forthwith inform the court about this fact. This is necessary due to the fact that during the bankruptcy proceedings there may arise different types of costs required to be paid. Therefore, the court may declare bankruptcy only in case that the debtor has assets sufficient at least to cover the costs of bankruptcy proceedings. The court must have the existence of the debtor's assets found and proven. If the court has doubts about the debtor's assets it is obliged to appoint an interim trustee (Đurica, 2006, p. 103). The interim trustee may be appointed only on a random basis using a hardware and software means of selection after the initiation of bankruptcy proceedings and the interim trustee function is held until the bankruptcy is declared or the proceeding is stopped due to lack of assets. The interim trustee shall determine the assets that actually belong to the debtor at the time of the performance of his function and discovers the property transferred from the debtor's assets by the legal acts, which may be reasonably expected to be opposed in case bankruptcy is declared. The interim trustee has the right for remuneration and reimbursement of documented expenses.

If the court declares the debtor bankrupt, in its decision of the bankruptcy it must always appoint the bankruptcy trustee on a random basis using a hardware and software tools of selection. This principle is broken if there was appointed an interim trustee in the bankruptcy proceeding. In this case, the court appoints the person appointed to function of interim trustee to function of bankruptcy trustee (§ 22 sec. 1 ZKR). If the court declares bankruptcy during the supervision followed after the end of restructuring, the supervision trustee must be appointed to the function of bankruptcy trustee by the court (§ 165, sec. 2 ZKR). The basic task of the bankruptcy trustee is to identify and write down assets subject to bankruptcy, to manage these assets, to monetize these assets and then to divide the yield among debtor's creditors. The bankruptcy trustee shall perform his duties from declaration of bankruptcy generally until the cancellation of bankruptcy or termination of his function due to other reasons, for example because of his dismissal. The bankruptcy trustee has the right to be paid remuneration for performance of his duties to the first meeting of creditors in amount of lump sum set by the court after the first meeting of creditors on the ground of proposal of the trustee. After the first meeting of creditors the trustee is entitled to be paid remuneration in amount determined as a percentage of the yields gained from monetizing assets subject to bankruptcy.

After the cancellation of bankruptcy there may follow proceeding on debt relief. Application for allowing debt relief may be filed by the debtor who is a natural person together with the application for declaration of bankruptcy or in bankruptcy proceedings until the cancellation of bankruptcy (§ 167 ZKR). The court must decide about the application for debt relief without delay after the cancellation of bankruptcy. If the court allows the debt relief there must be decided also on appointment of trustee in

debt relief on random basis using a hardware and software tools of selection. The trustee performs his function in the proceeding from date of allowing of the debt relief to date of publication of resolution on cancellation of the trial period or the decision on debtor's debts relief in the Business Journal. When debt relief is allowed there starts a three year trial period during which the debtor pays to the appointed trustee in debts relief sum in the amount specified by the court at the end of each trial year, which is then divided by the trustee proportionally among the creditors according to a final allocation of yields issued by the trustee after deducting his remuneration. During the trial period the trustee in debts relief performs supervision over the debtor in particular mainly by approving some of his legal acts. Range of the legal acts that are subject to approval by the trustee in debts relief are set by the court (§ 167 and 168 of ZKR).

The restructuring trustee is the person chosen from the list of trustees by the debtor or creditor (assuming that the debtor has agreed to provide the required cooperation) and instructed to issue an expert opinion. The task of the trustee is to evaluate whether there are met conditions for the restructuring. If the trustee recommends restructuring in the opinion, the debtor or creditor may apply for allowing the restructuring. If the court allows the restructuring, it also appoints the person that prepared the opinion to the function of trustee in restructuring. During the restructuring, the trustee in restructuring performs supervision over the business of the debtor in order to prevent him from decreasing the value of its assets or from frustration of the successful completion of the restructuring, he continuously evaluates the financial and trade situation of the debtor, he approves debtor's legal acts to the extent determined by the court, he cooperates in the process of preparation of the restructuring plan or he drafts the restructuring plan proposal and submits it for approval (§ 129, § 130, § 133 and 134 of ZKR). The restructuring trustee holds the function until the restructuring is stopped or until publication of the end of the restructuring in the Business Journal (§ 131, § 154 and 156 of ZKR). The reward of the restructuring trustee for the draft of the restructuring opinion as well as for performance in the restructuring proceedings is a matter of an agreement between the debtor and the trustee. If the application for preparing the restructuring report is filed by the creditor then the remuneration for it shall be subject to agreement between him and the trustee, however also in this case there is not excluded an agreement between the debtor and the trustee.

The implementation of the restructuring plan itself is made only after the restructuring. A binding part of the restructuring plan may therefore introduce the supervisory management over the debtor or acquiring person for the time after the restructuring until the fulfillment of the plan. The supervision is performed by the supervision trustee designated by mandatory part of the plan. The supervision trustee approves legal acts of a person subject to supervision, he evaluates all information on this person and on the implementation of the plan and he also performs other duties. The actual scope of the supervisory management is regulated in the restructuring plan, which shall also determine the remuneration of the supervisory trustee. The function of a supervisory trustee ends with the publication of a notice on termination of the supervisory management or on bankruptcy (§ 162 to 165 ZKR).

Forasmuch as the insolvency of a debtor is usually solved in bankruptcy, the trustees oftenly act as interim trustees or trustees in bankruptcy. In fact, we may state that most of them performed only the function of an interim trustee or trustee in bank-

ruptcy. Similarly to the previous regulation in practice bankruptcy is the most frequent way of resolving the debtor's insolvency.

### **3 The trustee in insolvency proceedings as entrepreneur and as a subject of the proceeding**

The position of trustee as an entrepreneur results from the act on trustees which states in its § 2. sec. 2 following: "Activities of a trustee may be performed only by a trustee" and refers to § 2. sec. 1 of the Commercial Code in a footnote, which defines the term business as a systematic activities independently conducted by an entrepreneur to make a profit in his own name and upon his own responsibility. The explanatory memorandum to the act on trustees states that trustee's activities have undoubtedly the character of business, i.e. character of activities performed continuously for profit. The question, whether the activity may be considered to be business is in our view at least disputable. Do the trustee's activities really meet all the attributes of business? Does the trustee perform its activities continuously, separately, in his own name, and upon his own responsibility in order to achieve profit? Is a trustee entrepreneur providing services?

As already mentioned above, in practice the trustee usually performs its duties in bankruptcy proceedings as an interim trustee or trustee in bankruptcy. He does provide services neither to creditors nor to the debtor. The interim trustee is appointed by the State via court to determine whether the debtor's assets are sufficient enough to cover at least the costs of bankruptcy proceedings and he shall forthwith inform the court about this fact. Appointment of an interim trustee to function is dependent on the random selection with hardware and software means. If the court declares the bankruptcy of the debtor's assets it also appoints an interim trustee to function of bankruptcy trustee. Although in practice the interim trustee is appointed in most of the insolvency proceedings, in cases where the court has no doubts about the debtor's assets it declares bankruptcy, even without appointment of interim trustee. The court must appoint a bankruptcy trustee by resolution on bankruptcy. A bankruptcy trustee is appointed by the State via court in order to liquidate the bankrupt's assets and to satisfy creditors' claims. If there was not appointed an interim trustee, appointment of a bankruptcy trustee to the function is dependent on random selection using a hardware and software means of selection. The trustee must respect the instructions of the court and the creditor's institutions in performance of his actions. According to § 40 of ZKR trustee performs administration of the assets subject to bankruptcy, monetizing the assets subject to bankruptcy, he satisfies creditors of the debtor from the obtained resources and he exercises other rights and obligations in accordance with the law. The trustee is not managing the assets in his own name but on behalf and expense of the debtor (ZKR § 44). The aim of the trustee can not be profit, but the satisfaction of creditors to the maximum extent possible. The purpose of monetizing the assets subject to bankruptcy is according to § 91 ZKR to get the highest yield in the shortest possible time with as low cost as possible. A trustee has the right to be paid the remuneration for his activities. The source of financing of the trustee shall always be in the assets subject to bankruptcy.

We incline to the view that the bankruptcy trustee can not be considered to be an entrepreneur (Balík, 2002, p. 28 and Pohl, 2002, p. 40). The trustee is the person with status and role *sui generis*. However, there are also appeared opposing views (Kubinec, 2006, p. 1705). We point out also that insolvency law in the Czech Republic based on Act no. 182/2006 Coll. on the Insolvency and Ways of its Solution (Insolvency Act), which entered into force on 1st of January 2008 does not consider insolvency trustees or other trustees performing the activities in the insolvency proceedings to be in the status of the entrepreneur (Zelenka, 2007, p. 82). A trustee does not have this status also in other European countries such as Germany, Austria, Hungary or Poland.

The Constitutional Court of the Czech Republic in its decision PI. U.S. 36/01 holds an interesting position. The trustee in bankruptcy is a particular body of public law whose role is to ensure the proper conduct of bankruptcy. The performance of the function of trustee in bankruptcy on the ground of appointment by the court may not be from the constitutional point of view subordinated under framework of works or services, the performance of the function of the trustee in bankruptcy is not part of the employment relationship, next it is not enterprising or performance of other economic activity (Křmář, 2005, p. 417).

The procedural status of trustee is regulated by the act on bankruptcy and restructuring. The trustee is not the participant, but is an important procedural subject participating in the bankruptcy proceeding, restructuring proceeding and proceeding on debt relief. He takes the position of participant in the proceeding only in cases when there is being decided on his rights and obligations (§ 24 and 119 ZKR). In its capacity the trustee has an obligation to protect the interests of participants in the proceedings, however in order to be objective he is not an agent or representative of creditors or the debtor (bankrupt). The trustee has the rights and obligations that are imposed on him by law in first place, as well as by the court in the second place and its action must be in compliance with the mandatory instructions of the court, creditors and creditor's institutions. In this relation we point out the opinion of the Civil and Commercial College of the Supreme Court of Czech Republic dated 16.6.1998, Cpjn 19/98, XIX: "The bankruptcy trustee is not a party to bankruptcy proceedings. As the special procedural subject he has an independent status against the bankrupt, as well as against the bankrupt's creditors and can not be considered to be representative of the bankrupt's creditors or representative of the bankrupt" (Ďurica, 2006, p. 49).

## Conclusion

Following the adoption of the Bankruptcy and Restructuring Act and the act on trustees, the requirements placed on trustees and their activities have changed. Unlike the past the activities of trustee are more difficult, the trustee has much more responsibilities in relation to the court and to the creditors. Contemporary legislation has also brought a change in the position of the trustee. The position of the trustee as an entrepreneur is however disputable. The fact that there results certain restrictions for the performance of trustees' activities from the act on trustees and the act on bankruptcy and restructuring such as the trustee is appointed to the function by the court (state authority) on a random basis, the trustee must follow the instructions of the court and

the creditors' bodies, he may be excluded from performance of trustees' activities, the court that appointed the trustee to the function may also revoke him, the trustee is remunerated at the rates with the possibility of cuts from the side of the court sufficiently reason a conclusion on the absence of some substantial attributes of business, such as steadiness, independence and purpose of achieving a profit. The trustee does not have the status of the entrepreneur also in neighboring countries.

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