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Insolvency

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LAW AND PRACTICE: p.3

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The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

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BBH, advokátní kancelář, s.r.o. has offices in Prague and Bratislava, and extensive experience of representing foreign entities before Czech courts, so is able to provide unique support in cross-border matters. The insolvency team consists of ten highly experienced lawyers, two of whom are partners. The group has been involved in many of the largest insolvency cases over the last decade, covering a wide range of economic areas, including the financial sector, construction and industrial engineering, real estate and retail.

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1. Market Trends and Developments

1.1 The State of the Restructuring Market

According to the press release issued by Creditreform s.r.o. (*Vývoj insolvencí v České republice v roce 2017*), the number of insolvency petitions in the Czech Republic has been progressively decreasing since 2013, when the highest ever number of insolvency petitions was recorded. There were decreases of 4.8% in 2014, 7.9% in 2015 and 8.8% in 2016. Between 2016 and 2017, the year-on-year decline amounted to 21.6%, with a total of 1,803 company insolvency petitions filed in 2017. This positive trend has been driven primarily by a growing economy, but also reflects a number of pro-debtor changes in the insolvency legislation, and it is expected to continue in 2018 and 2019.

In recent years, the industrial sectors with the highest percentage of insolvent companies include the paper industry, mining, the chemical industry and heavy engineering. However, the greatest number of insolvency petitions (in absolute numbers) have been filed in the building industry and wholesale.

The average length of insolvency proceedings in the Czech Republic is approximately two years (from the commencement of an insolvency proceeding to the full or partial satisfaction of creditors). However, the level of satisfaction of registered creditors is very low in the long term: secured creditors get paid circa 30% of the value of their registered claims on average, and unsecured creditors receive much less – only circa 4–5% on average.

1.2 Changes to the Restructuring and Insolvency Market

The latest legislative developments indicate that there is an increasing emphasis on the early resolution of debtors' insolvency, preferably by way of reorganisation. In 2017, 1,554 companies were declared bankrupt, compared to only 20 cases in which the insolvency court approved a reorganisation. Between 2008 and 2017, there were only 180 company reorganisations in total.

The legal conditions for approving reorganisations were relaxed on 1 January 2014, making reorganisation more accessible to a greater number of debtors, who are seek-

ing reorganisation more frequently. At the same time, a so-called 'pre-packaged' reorganisation option has become increasingly popular, which works by the debtor agreeing the restructuring measures and the main terms of a reorganisation plan in advance with its creditors on, and ensuring their majority support. All of these negotiations and the preparation of the reorganisation plan and supplementary documentation take place before the commencement of the given insolvency proceedings (the filing of an insolvency petition), which significantly speeds up the subsequent formal reorganisation process.

Reorganisation usually involves the entry of a strategic investor, who either provides loan financing to the debtor or purchases its entire business at a price that is acceptable to the creditors. If a loan is provided to a debtor under the Insolvency Act, the lender obtains a preferential claim, which is to be satisfied in priority to the claims of other creditors (including secured creditors). This enables the funding of companies undergoing insolvency proceedings, maintains their cash flow and thus allows for their reorganisation. If a debtor's business is to be sold within reorganisation, the purchaser is usually chosen in an open and transparent tender procedure. As such procedures are usually quite time-consuming and costly, it has become more common of late for a particular investor to be consented to between the debtor and its creditors in advance, which is one of the main advantages of pre-packaged reorganisations.

The latest amendment to the Insolvency Act, effective from July 2017, introduced several pro-debtor provisions that contributed to an overall decrease in the number of filed insolvency petitions. These provisions include, in particular, the protection of solvent companies against frivolous insolvency petitions, a tightening of the rules for evidencing the receivables of insolvency petitioners and the negative assumption of insolvency.

2. Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations

2.1 Overview of the Laws and Statutory Regimes

In the Czech Republic, the insolvency of both natural and legal persons (in Czech: *'úpadek'*) and the ways of its resolution – bankruptcy (in Czech: *'konkurs'*), reorganisation (in Czech: *'reorganizace'*) and debt clearance (in Czech: *'oddlužení'*) – are governed primarily by Czech Act No 182/2006 Coll., the Insolvency Act (hereinafter referred to as the 'Insolvency Act'). The rules of the procedure for insolvency proceedings are further elaborated in Regulation No 311/2007 Coll. Regulation No 191/2017 Coll. contains formal and content requirements for various documents to be submitted during insolvency proceedings, such as the insolvency petition and reorganisation plan. In addition, Act No 312/2006 Coll., on Insolvency Trustees, sets out legal requirements for a person to become an insolvency trustee, regulates the suspension and termination of the office of an insolvency trustee, and lays down rules for the supervision of insolvency trustees by the Ministry of Justice.

The purpose of insolvency proceedings is to deal with a debtor's insolvency in a way that achieves the highest possible satisfaction of the debtor's creditors, either by the realisation of the debtor's assets and distribution of the proceeds (bankruptcy procedure – see **7 Statutory Insolvency and Liquidation Proceedings**, below), or by enacting the restructuring arrangements laid down in the approved reorganisation plan while maintaining the operation of the debtor's enterprise (reorganisation procedure – see **6 Statutory Restructurings, Rehabilitations and Reorganisations**, below).

Insolvency proceedings are conducted and supervised by the insolvency court, which is a regional court in whose jurisdiction the debtor is domiciled or permanently resides (natural persons) or has its registered office (legal persons). If a debtor is registered in the commercial register, the insolvency court is determined based on the data that is valid on the date six months preceding the commencement of the insolvency proceedings (if any), which should prevent debtors from intentionally influencing the court's jurisdiction and the range of insolvency trustees that might be appointed. Insolvency courts also decide incidental disputes arising from insolvency proceedings (eg, disputes on the existence, amount or priority of denied claims).

Under Czech law, liquidation (in Czech: *'likvidace'*) is a voluntary or involuntary formal statutory process resulting in the dissolution of a solvent company. The process of liquidation is generally regulated by the provisions of Act No 89/2012 Coll., the Civil Code (hereinafter referred to as the 'Civil Code'), and, in relation to business companies and co-operatives, Act No 90/2012 Coll., on Business Corporations (hereinafter referred to as the 'Business Corporations Act'). If a liquidator finds out that the liquidated company is in insolvency under the Insolvency Act, he or she is obliged to file for insolvency and a bankruptcy procedure is commenced.

Restructurings carried out within insolvency proceedings (ie, reorganisations) are regulated by the Insolvency Act itself; restructurings outside insolvency proceedings (ie, involving companies that are not in insolvency under the Insolvency Act – thus, any out-of-court restructuring) are not specifically regulated under Czech law, and general rules governing the conclusion of agreements between business entities and corporate actions apply.

2.2 Types of Voluntary and Involuntary Financial Restructuring, Reorganisation, Insolvency and Receivership

When a company meets the criteria for insolvency under the Insolvency Act, formal insolvency proceedings shall always be opened, without exception (it is a mandatory procedure). However, the insolvency court may not commence an insolvency proceeding by itself, but only upon an insolvency petition being filed with the insolvency court, either by a debtor (who bears a legal obligation to do so) or by any of its creditors with a due receivable.

Insolvency proceedings may also be opened voluntarily, but only in the event of the so-called 'imminent' insolvency of the debtor (in Czech: *'hrozící úpadek'*), as opposed to a 'current' insolvency – ie, if it can be reasonably assumed that the debtor will not be able (in the near future) to fulfil a substantial part of its financial obligations in a due and timely manner. In such cases, the debtor is not obliged to file for insolvency, but is permitted to do so. Creditors are not entitled to file insolvency petitions in the imminent insolvency of a debtor.

If the insolvency court declares a debtor's insolvency (ie, if the insolvency petition is approved rather than rejected or dismissed), then either a reorganisation procedure or a bankruptcy procedure is commenced within the insolvency proceedings, depending on whether the statutory criteria for reorganisation are met and, if so, what procedure is preferred by creditors. The third way of dealing with a debtor's insolvency – debt clearance – is available for natural persons only.

Besides reorganisations carried out within insolvency proceedings, no other special restructuring regimes relating to ordinary business companies are regulated under Czech law. Special regimes apply to banks and other financial institutions that are subject to special financial regulation.

2.3 Obligation to Commence Formal Insolvency Proceedings

After the occurrence of insolvency (in the form of illiquidity or over-indebtedness; please see **2.7 Requirement for Insolvency to Commence Proceedings**), a company is obliged to file an insolvency petition with the insolvency court without undue delay, which commences formal insolvency proceedings. The directors of the company have the same obligation. If a company has previously entered into liquidation, the obligation lies with the liquidator of the company.

In cases of imminent insolvency, a company (its representatives) is not obliged to file for insolvency but is permitted to do so, and thus solve its adverse financial situation in advance, which is beneficial to its creditors and increases its chances of successful reorganisation.

2.4 Procedural Options

A debtor is obligated to open formal insolvency proceedings in the event of insolvency, with no exceptions. There is no possibility to opt for an alternative, such as administration or receivership, as these procedures are unknown in Czech law.

Within insolvency proceedings, the debtor may file for reorganisation (if permissible under the Insolvency Act) or bankruptcy (or, as the case may be, the debtor may refrain from making any suggestion as to the way of dealing with its insolvency). Another alternative is that the debtor submits a pre-agreed reorganisation plan to the insolvency court when filing for insolvency (the so-called 'pre-packaged' reorganisation). In such cases, the insolvency court will permit the reorganisation (if permissible in respect of the debtor in question) together with the insolvency decision, and the issue (whether reorganisation or bankruptcy) is not subject to the vote of the creditors at a creditors' meeting, as would otherwise be the case.

2.5 Liabilities, Penalties or Other Implications for Failing to Commence Proceedings

If the directors of a company (or liquidator) fail to file for insolvency and to open insolvency proceedings when obliged to do so, each of them shall be personally liable for damages to the creditors. Each creditor may ask for reimbursement up to the difference between the amount of its claim to be satisfied and the amount of satisfaction actually received on its claim in the insolvency proceedings. Obligated persons may be relieved of liability only if they prove that the failure to initiate insolvency proceedings had no impact on the extent of satisfaction of the creditors' claims, or that such failure was caused by facts that occurred independently of their will and that could not have been averted with all possible efforts.

Failure to file for insolvency may also trigger criminal liability. For other liabilities, penalties and implications for directors of companies, please see **12 Duties and Personal Liability of Directors and Officers of Financially Troubled Companies**.

2.6 Ability of Creditors to Commence Insolvency Proceedings

Creditors are entitled to file an insolvency petition against a debtor, and thereby commence insolvency proceedings, under basically the same conditions as the debtor itself (ie, primarily upon the occurrence of the debtor's insolvency – not only imminent insolvency, which must be duly evidenced). In addition, such creditors must prove that they have a due receivable against the debtor, and must lodge their claim together with the insolvency petition. Persons other than creditors or the debtor itself may not commence insolvency proceedings.

The receivable of insolvency petitioners must be of a certain quality. Insolvency petitioners are obliged to document

their receivables by either the debtor's acknowledgement or an enforceable decision or notarial deed with enforceability permission, or by the confirmation of a qualified person that the receivable is recorded in the creditor's accounting. This should prevent creditors from filing insolvency petitions on the basis of unfounded or disputed receivables, and should protect debtors against frivolous insolvency petitions.

2.7 Requirement for Insolvency to Commence Proceedings

Insolvency proceedings are commenced automatically upon the delivery of an insolvency petition to the competent insolvency court. However, the insolvency court subsequently ascertains whether the debtor is actually in insolvency under the Insolvency Act. If not, the insolvency petition is dismissed and the insolvency proceedings are terminated. If it is, the debtor's insolvency is declared by the insolvency court, and the insolvency proceedings continue with the reorganisation or bankruptcy procedure. Thus, a debtor's insolvency is a fundamental prerequisite for insolvency proceedings, even though not directly for their commencement.

Insolvency under the Insolvency Act (in Czech: *'úpadek'*) primarily means that a debtor has at least two creditors whose receivables against the debtor are more than 30 days overdue, and said debtor is unable to pay its due liabilities (liquidity test). The last condition (illiquidity; in Czech: *'platební neschopnost'*) is presumed to have been met especially if the debtor has stopped paying a substantial part of its liabilities, or if its liabilities are more than three months overdue. On the other hand, a debtor is presumed not to be insolvent if the difference between the amount of its due liabilities and the amount of its available funds shown in a liquidity statement at the moment or in the foreseeable future is less than 10% of the amount of its due liabilities (the so-called negative assumption of insolvency).

A debtor's insolvency may also take the form of over-indebtedness (in Czech: *'předlužení'*), which is when a debtor has at least two creditors and the aggregate of its liabilities exceeds the value of its assets, which value is to be determined considering the continuation of the company as a going concern (adjusted balance sheet test).

2.8 Specific Statutory Restructuring and Insolvency Regimes

A special regime applies to the insolvency of financial institutions, which is subject to special provisions contained in Chapter IV of the Insolvency Act. These provisions apply to banks, savings and credit co-operatives, foreign banks operating in the Czech Republic on the basis of the European single banking licence, investment firms, branches of foreign banks and investment firms, and insurance companies, but only after their licence or authorisation has ceased to be valid (except for investment firms). For the duration of the licence or authorisation of such institutions, their financial difficulties are regulated by special laws, and the Insolvency Act will not apply.

Compared to the standard insolvency procedures, the main specifics for financial institutions include that insolvency petitions may also be submitted by its supervisory authority (ie, the Czech National Bank) as well as the financial institution itself and its creditors. Furthermore, only an insolvency trustee with a special authorisation may be appointed the insolvency trustee of a financial institution. Financial institutions will always undergo the bankruptcy procedure; reorganisation is not admissible. Considering the great number of creditors in such proceedings, the special provisions also provide that creditors whose receivables are recorded in the accounting books of the financial institution do not have to lodge their claims as they are automatically deemed to have been lodged, which will be notified to any such creditor by the insolvency trustee.

The Insolvency Act shall not apply in any case to the state (Czech Republic), self-governing territorial units (municipalities and regions), the Czech National Bank, the General Health Insurance Company of the Czech Republic, public universities and certain other specific institutions. A legal person providing public services (eg, railways, hospitals) is subject to the Insolvency Act unless the state or a self-governing region undertakes to pay all of its debts or to provide a guarantee before the commencement of insolvency proceedings.

3. Out-of-court Restructurings and Consensual Workouts

3.1 Consensual and Other Out-of-court Workouts and Restructurings

Under Czech law, business entities are considered to be in insolvency under the Insolvency Act (in Czech: *'úpadek')* if they have multiple creditors and either (i) have liabilities more than 30 days overdue that they are unable to pay, or (ii) are over-indebted (for more information, please see **2 Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations**). In such cases, companies (and their statutory representatives) are obliged to file for insolvency and commence mandatory insolvency proceedings under the Insolvency Act, and any out-of-court restructuring is strictly prohibited.

As long as a company's adverse financial situation does not reach insolvency under the Insolvency Act, market participants in the Czech Republic are permitted and clearly tend to explore all of their out-of-court restructuring options. As Czech law does not regulate consensual restructuring processes specifically (there is no formal statutory process or even legal framework), and therefore only general legal institutes and principles apply, companies are allowed to tailor

the solution of their indebtedness to their business needs more than they would be able to under formal insolvency proceedings.

The Insolvency Act also does not provide any limitations in relation to out-of-court restructurings (as long as the criteria for insolvency are not met). However, it must be borne in mind that, if such consensual restructuring will not lead to the stabilisation of a company's financial situation, followed by its insolvency being declared by the insolvency court in insolvency proceedings, the Insolvency Act allows the setting aside of transactions that would shorten the satisfaction of creditors or favour certain creditors over others (please see **13 Transfers/Transactions That May Be Set Aside**). This could also affect transactions carried out under a previous restructuring process if they fall within the 'look-back period'.

3.2 Typical Consensual Restructuring and Workout Processes

As Czech law does not provide any legal framework for consensual restructurings, each restructuring is different and it would be overambitious to offer a description of a *typical* restructuring process. Each process differs substantially based on the level of indebtedness, the structure of the debtor's assets, the type of goods or services provided by the debtor, the number and structure of creditors, and an uncountable number of other aspects.

However, the fundamental prerequisite of any out-of-court restructuring is the willingness of creditors to participate. In order to create at least a minimum level of certainty during a restructuring process, creditors (usually with the participation of the debtor and/or its shareholders) tend to set down the basic rules and principles of the restructuring process at its beginning, especially by concluding a so-called 'standstill agreement', which usually includes a set of default waivers.

Another typical attribute of a restructuring process is the execution of a thorough due diligence report on the debtor. The subject matter of such due diligence is rather extensive and includes a detailed analysis of the debtor's position. Results of such due diligence serve as the assessment of feasibility of the restructuring, and set the most optimal restructuring arrangements.

Consensual restructuring processes may result in a wide variety of arrangements. Common arrangements often include the extension of the due dates of respective financial liabilities, haircuts of total liabilities, the restructuring of the debtor's operations, the sale of the debtor's enterprise, its part or individual assets, the injection of new money, subordination clauses, or the renegotiation of supplier contracts towards more favourable terms for the debtor. Concurrently, the debtor is ordinarily obliged to regularly fulfil various informational and disclosure duties (usually to a similar extent as is required by banks when providing loans), and it is not unusual for creditors' representatives to be installed into the statutory or supervisory bodies of the debtor.

3.3 Injection of New Money

New money is typically injected into financially distressed companies via new secured loans, provided most often by banks or (other) existing secured creditors. Security is usually provided, as far as possible, in the form of a first-priority pledge over the debtor's assets (eg, shares, real estate, receivables, stocks or whole enterprise). Although Czech insolvency law recognises the concept of super-priority loans, this super-priority regime only applies to loans provided during insolvency proceedings under the conditions set out by the Insolvency Act for loan financing (for more detail, please see **5.9 Priority Claims**). Any secured loan (including "new money") provided to the debtor outside insolvency proceedings shall have the regime of a secured (not preferential) claim in any insolvency proceedings and shall be satisfied out of the proceeds from the realisation of collateral, depending on the priority of the respective security.

It is quite common for new money to be injected by a debtor's shareholders, other controlling persons or other companies belonging to the same group via intra-group loans, which are often subordinated to bank loans.

3.4 Duties of Creditors to Each Other, or of the Company or Third Parties

As any out-of-court restructuring is an informal process under Czech law, laws neither provide special rules of conduct in relation to out-of-court restructurings nor impose specific duties on creditors, debtors, shareholders or third parties in this respect. The whole process is governed by generally applicable legal provisions and principles, especially those arising out of civil and company law. In particular, directors of interested companies must always act with due managerial care and honesty, and in compliance with their duty of good faith and loyalty. Similarly, shareholders or members of the company are subject to the duty of loyalty, which prevents them from voting in an abusive manner or to the detriment of the company.

3.5 Consensual, Agreed Out-of-court Financial Restructuring or Workout

Due to the absence of specific regulation of out-of-court restructurings, there are no statutory cram-down mechanisms under Czech law to deal with dissident (minority) creditors in order to accomplish consensual out-of-court restructurings. It follows that any such restructuring can be effectuated only upon the consensus of all involved parties.

The dissent of minority creditors may be overcome only if the restructuring is carried out within formal insolvency proceedings brought against the debtor (ie, in reorganisa-

tion), provided the required majority of creditors supports the proposed solution.

4. Secured Creditor Rights and Remedies

4.1 Type of Liens/Security Taken by Secured Creditors

Under Czech insolvency law, secured creditors are only those creditors whose receivables are secured by collateral belonging to a debtor's insolvency estate, namely by way of a pledge, lien, restriction on the transfer of real estate, assignment of a right, by way of security or similar security instruments created under foreign law.

Accordingly, any other types of security, such as personal guarantees or promissory notes issued as security, do not give rise to the position of a secured creditor in insolvency proceedings.

The most commonly used form of security is a pledge (in Czech: '*zástavní právo*'),which can be created over any tradable assets belonging to a company, including, by way of example, real estate, equity shares, movable property, accounts and other receivables, intellectual and other intangible property, or enterprises as a whole.

4.2 Rights and Remedies for Secured Creditors

Outside insolvency proceedings, secured creditors enforce their security in accordance with the respective clauses of security agreements, or in accordance with the general rules contained primarily in the Civil Code and other applicable laws.

After the commencement of insolvency proceedings, no new security can be validly created over the debtor's assets, and existing security is subject to the automatic stay of enforcement. Secured creditors do not have a right to stay or defer the opening of insolvency proceedings, but may hinder their smooth running by the frequent filing of various appeals. Secured creditors must also lodge their claims as secured in order to acquire the status of secured creditors in insolvency proceedings.

In bankruptcy, a secured creditor has the right to issue binding (with certain exceptions) instructions to the insolvency trustee as regards the maintenance and realisation of the respective collateral, and to have its secured claim satisfied out of the proceeds from the realisation of the respective collateral (minus the insolvency trustee's fee and maintenance and realisation costs), up to the amount of the respective secured claim (or to the appropriate extent if such claim is not secured in the full amount). If multiple creditors have security interests in the same asset, then such creditors may both issue instructions and be satisfied based on the priority of their security. Proceeds from the realisation of collateral shall be released to respective secured creditors by the insolvency trustee immediately, at any time during the insolvency proceedings, with the prior consent of the insolvency court (on the contrary, unsecured creditors are ordinarily satisfied at the end of the proceedings after all or a substantial part of the debtor's assets have been realised). Unless the proceeds are sufficient for the full satisfaction of the respective secured claim, the outstanding amount of the claim is designated as unsecured.

In reorganisation, all rights of secured (as well as unsecured) creditors derive from the approved reorganisation plan. Unless a secured creditor agrees to less favourable terms, such creditor must receive consideration under the reorganisation plan at least in the value of its security, which is provided in the expert's report.

4.3 The Typical Timelines for Enforcing a Secured Claim and Lien/Security

After the commencement of insolvency proceedings, the insolvency court ascertains whether or not the debtor is in insolvency under the Insolvency Act, based on the proper and complete insolvency petition. Accordingly, the insolvency court either declares the debtor's insolvency or dismisses the insolvency petition. In most cases, the decision is taken within a month or two.

Subsequently, creditors (both secured and unsecured) have to lodge their claims within two months (a special regime applies to creditors from member states of the EU). All registered claims are then subject to review by the insolvency trustee and the debtor at a review hearing that takes place two months after the time limit for lodging claims has elapsed, at the latest. Claims that were denied as to their existence, amount and/or priority by the insolvency trustee (or by the insolvency trustee and/or the debtor in reorganisations) cannot be satisfied in insolvency proceedings (or satisfied with given priority) unless their existence, amount and/or priority is ascertained by the insolvency court in incidental proceedings. Denied claims bear no voting rights unless they are granted by a creditors' meeting or the insolvency court upon substantiated request of the respective creditor.

The insolvency court then decides on the insolvency resolution method (reorganisation or bankruptcy; debt clearance is for natural persons only). Except for the expedited reorganisation procedure ('pre-packaged' reorganisation – please see **6.1 The Statutory Process for Reaching and Effectuating a Financial Restructuring/Reorganisation**), the decision is ordinarily taken approximately three months after the insolvency decision. The court's decision reflects the will of the creditors, if they have adopted a decision by the required majority. If reorganisation is not permissible in the particular case, or if neither the debtor nor any of the creditors seek reorganisation, or if the dishonest intent of

the debtor is established, the insolvency court will rule on the debtor's bankruptcy.

Depending on the chosen method, this is followed either by the realisation of the debtor's assets (in bankruptcy) or by the preparation and fulfilment of the approved reorganisation plan, if approved by the insolvency court (in reorganisation). There is no specific timeline for the realisation of assets (including collateral) in bankruptcy, so it depends particularly on the individual instructions given by secured creditors (which are, with certain exceptions, binding on the insolvency trustee) and the chosen methods of realisation. Proceeds from the realisation of assets shall then be released to the respective secured creditor(s) without undue delay. In reorganisation, a concrete process and timeline of satisfaction of both secured and unsecured creditors derive entirely from the reorganisation plan, depending on the chosen restructuring arrangements, and differ from case to case.

4.4 Special Procedures or Impediments That Apply to Foreign Secured Creditors

Czech insolvency law is based, among other things, on the principle that creditors who have essentially the same or similar positions shall have equal rights in insolvency proceedings, which is fully applicable to both domestic and foreign creditors, both secured and unsecured.

However, in respect of foreign creditors (both secured and unsecured) who have their habitual residence, domicile or registered office in a Member State of the European Union, special procedures laid down in Regulation (EU) 2015/848 on Insolvency Proceedings (hereinafter referred to as the 'EU Insolvency Regulation') shall apply. In compliance with the EU Insolvency Regulation, the insolvency court shall immediately and individually inform (by using a prescribed notice form) each known foreign EU creditor of the debtor about the commencement of insolvency proceedings, the insolvency decision, and the procedure and time limits for lodging claims. Foreign EU creditors lodge their (simplified) claims via a standardised claims form in accordance with the EU Insolvency Regulation. The time limit for lodging claims shall not begin before the foreign EU creditor has received the prescribed information and notices from the insolvency court.

4.5 Special Procedural Protections and Rights for Secured Creditors

In addition to the above, secured creditors have a preferential right to provide the debtor with loan financing in the course of the insolvency proceedings under the Insolvency Act, which shall constitute a priority claim.

In every reorganisation and if the debtor's enterprise has been sold as a whole, secured creditors shall be paid a contractual interest (if any) accruing on their secured claims from and after the insolvency decision, although otherwise such interest shall not be satisfied in the insolvency proceedings at all.

5. Unsecured Creditor Rights, Remedies and Priorities

5.1 Differing Rights and Priorities Among Classes of Secured and Unsecured Creditors

Generally, the Insolvency Act recognises certain priority claims that do not need to be lodged in insolvency proceedings by their creditors and shall be satisfied in full, as far as is possible, at any time after an insolvency decision (please see **5.9 Priority Claims**). Priority claims bear no voting rights.

All other claims must be lodged in insolvency proceedings within a statutory time period, or they cannot be satisfied in insolvency proceedings. These include secured and unsecured claims, contingent claims (ie, claims subject to a condition) and subordinated claims.

Secured claims are those that are secured against collateral belonging to the debtor's insolvency estate, namely by way of a pledge, a lien, restriction on the transfer of real estate, assignment of a right or receivable by way of security, or similar security instruments created under foreign law (for more details please see **4 Secured Creditor Rights and Remedies**). Any other claims are unsecured for the purposes of insolvency proceedings.

Contingent claims may only be satisfied if the given condition is fulfilled. Creditors of contingent claims do not have voting rights until such condition is fulfilled. There might be secured as well as unsecured contingent claims.

Subordinated claims include claims:

- that are subordinated under respective contractual documentation;
- that arise out of subordinated bonds; and
- of shareholders or members of the debtor arising from their participation in the company (eg, unpaid dividends).

Creditors of subordinated claims do not have voting rights and shall be satisfied only if all higher-ranking claims have been fully satisfied, which is virtually only a theoretical possibility.

Certain claims will not be satisfied in insolvency proceedings at all – eg, default or contractual interest due or accruing on registered claims from and after an insolvency decision (with a minor exception concerning secured creditor claims, as mentioned in **4.5 Special Procedural Protections and Rights for Secured Creditors**), costs of insolvency proceedings, receivables under gift agreements, etc.

5.2 Unsecured Trade Creditors

Unsecured creditors, including unsecured trade creditors, whose claims existed at the time of the opening of insolvency proceedings are usually satisfied only partially, on a pro rata basis. However, any claims (including those of trade creditors) that arise after an insolvency decision under newly concluded agreements or agreements that have remained valid and effective under the conditions laid down by the Insolvency Act are granted a priority status in insolvency proceedings (priority claims).

In reorganisation plans, unsecured trade creditors usually constitute one class, but might be divided into smaller classes at the discretion of the author of the reorganisation plan, unless it means that creditors with practically identical legal positions and economic interests are intentionally assigned to different classes, which is not permissible.

5.3 Rights and Remedies of Unsecured Creditors

After the commencement of insolvency proceedings, both unsecured and secured claims cannot be enforced outside the insolvency proceedings, but need to be lodged (except for priority claims and subordinated claims of shareholders). Unsecured creditors do not have a right to stay or defer the opening of the insolvency proceedings, but may hinder its smooth running by the frequent filing of various appeals (the same applies to secured creditors).

Unsecured creditors have the same voting rights as secured creditors. In relation to most of the important decisions, both a majority of unsecured creditors and a majority of secured creditors must consent in order for such decision to be adopted. This also applies, with a minor exception, to voting on the insolvency method resolution (reorganisation/bankruptcy).

After priority claims have been satisfied in full, unsecured creditors have the right to be satisfied on a pro rata basis out of the proceeds from the realisation of the debtor's assets that have not been subject to security and, eventually, any surplus proceeds from the realisation of collateral (in bankruptcy). In reorganisation, all rights of unsecured (as well as secured) creditors derive from a reorganisation plan. Unsecured creditors are most often paid a certain percentage of their claims or given the right to capitalise their claims into equity.

5.4 Pre-judgment Attachments

Pre-judgment attachments are not available under Czech law.

5.5 Typical Timeline for Enforcing an Unsecured Claim

A typical timeline for enforcing an unsecured claim in insolvency proceedings is similar to a secured claim (please see **4.3 The Typical Timelines for Enforcing a Secured Claim and Lien/Security**). Except in bankruptcy, the final distribution of proceeds takes place upon the realisation of a whole insolvency estate, which usually takes several years, depending especially on the liquidity and attractiveness of individual assets. Proceeds may also be distributed during the insolvency proceedings, but this usually happens only if a substantial part of the debtor's assets or any more valuable asset has been realised, so that the distribution of proceeds makes practical sense. The realisation of the debtor's assets is at the full discretion of the insolvency trustee, who shall act with the prior consent of the creditors' committee and, in certain cases, the insolvency court.

In reorganisation, unsecured claims are usually satisfied in a much shorter time, from several months to a couple of years, depending on the restructuring arrangements chosen.

5.6 Bespoke Rights or Remedies for Landlords

There are no special bespoke rights or remedies for landlords in connection with insolvency proceedings under Czech law.

5.7 Special Procedures or Impediments or Protections That Apply to Foreign Creditors

Please see **4.4 Special Procedures or Impediments That Apply to Foreign Secured Creditors**.

5.8 The Statutory Waterfall of Claims

In bankruptcy, priority claims shall always be satisfied in the first place, namely in the following order:

- cash expenses and remuneration of the insolvency trustee;
- claims arising under moratorium;
- claims arising out of loan financing provided under the Insolvency Act;
- costs incurred in connection with the maintenance and realisation of the insolvency estate and employee claims;
- claims for damages in connection with health injury; and
- other priority claims.

Unsecured claims shall then be satisfied (pro rata). Finally, if any proceeds were left, subordinated claims would be satisfied (pro rata), except for claims of shareholders or members of the debtor arising out of shareholder/member positions, which would always be satisfied last in order.

Secured claims stand almost completely out of the statutory waterfall of claims. A secured claim shall be satisfied up to its full amount out of the proceeds from the realisation of the respective collateral up to its full amount at any time. Such proceeds may not be used for the satisfaction of any other claims (including priority claims), unless the respective secured claim is fully satisfied. Should the proceeds not be sufficient to satisfy the respective secured claim in full, the outstanding part is then ranked as unsecured, and is satisfied on a pro rata basis with other unsecured claims.

In reorganisation, priority claims shall be satisfied in full prior to the approval of a reorganisation plan. The means and the order of satisfaction of other claims are determined by the approved reorganisation plan.

5.9 Priority Claims

Priority claims are those that arise in the course of insolvency proceedings, namely insolvency trustees and members of the creditors' committee fees, costs incurred in connection with the maintenance and realisation of an insolvency estate, new money provided as loan financing under the Insolvency Act, employee and pension claims, tax and insurance claims, alimony claims, claims for damages in connection with health injury, any claims arising out of contracts entered into by a debtor/insolvency trustee after an insolvency decision, etc.

Creditors simply set their priority claims up against the debtor (in reorganisation) or the insolvency trustee (in bankruptcy) at any time during the insolvency proceedings. Priority claims shall be satisfied in full at any time after an insolvency decision.

5.10 Priority Over Secured Creditor Claims

There are no claims with priority over secured creditor claims under Czech law.

6. Statutory Restructurings, Rehabilitations and Reorganisations

6.1 The Statutory Process for Reaching and Effectuating a Financial Restructuring/ Reorganisation

Under Czech law, statutory restructuring (reorganisation) takes place only within formal insolvency proceedings, meaning that the reorganisation procedure involves insolvency proceedings being brought against a particular debtor and the insolvency court deciding that the debtor is in insolvency under the Insolvency Act. All court decisions and documents (including the reorganisation plan) are officially published on the insolvency register.

As opposed to bankruptcy, reorganisation aims to preserve the operation of a debtor's business while concurrently satisfying the claims of creditors to an agreed extent by adopting restructuring arrangements in accordance with an approved reorganisation plan.

Unlike bankruptcy, reorganisation is not a universal way of dealing with debtors' insolvency as it is not available to every company, but, in principle, only to bigger companies with either a total annual net turnover for the last accounting period of at least CZK50 million (approximately EUR1,820,000), or at least 50 employees. However, failure to fulfil the statutory conditions may be overcome if the debtor submits a reorganisation plan to the insolvency court pre-agreed by a simple majority of secured creditors and a simple majority of unsecured creditors prior to the insolvency decision. In no case will reorganisation be available for companies in liquidation, securities brokers, or persons authorised to trade on a commodities exchange.

Another fundamental prerequisite for reorganisation is that the debtor or any of its creditors must have petitioned to the insolvency court that the debtor's insolvency be dealt with by the reorganisation procedure, by filing a separate motion within the time limits laid down in the Insolvency Act. If no such motion is submitted, the insolvency court will decide on the debtor's bankruptcy.

Subject to the conditions stated above, the insolvency court will permit a debtor's reorganisation if it is agreed by an absolute majority of both secured and unsecured creditors who have voting rights or, alternatively, by 90% of all votes, otherwise only provided that the application for reorganisation was submitted by the debtor without a dishonest intent. In any event, no reorganisation may be effectuated unless a reorganisation plan is subsequently approved by the insolvency court (see below). If the insolvency court does not permit reorganisation or approve the reorganisation plan, a bankruptcy procedure will be commenced.

Each reorganisation is carried out based on a reorganisation plan, which lays down the rights and obligations of the debtor, its creditors and other parties involved, and the restructuring arrangements. The debtor has a preferential right to submit a reorganisation plan, but not later than eight months after the insolvency court has permitted the reorganisation. There are no limitations on agreements or compromises effectuated under a reorganisation plan, except for general principles of law and insolvency proceedings. Common arrangements are, for example, the restructuring of creditors' claims, the sale of the insolvency estate, its part or the debtor's enterprise, obtaining loan financing, the merger of the debtor with another legal entity, and/or the issuance of new shares for the purposes of a debt-equity swap.

The insolvency court shall approve a reorganisation plan on the following conditions:

- it complies with law;
- it was accepted by a prescribed majority of creditors in each class of creditors or, eventually, at least in one class, provided special conditions are met (especially regarding the overall 'fairness' of the plan);
- creditors get at least the same or higher satisfaction than if the debtor's assets were liquidated in a bankruptcy procedure;
- priority claims have been fully paid; and
- the debtor's intents are not dishonest; dishonest intent is typically inferred if the debtor conceals some of its creditors, provides untrue data or adjusts its financial state-

ments, attempts to treat certain creditors preferentially or breaches its duties under the Insolvency Act, or if its directors have recently been convicted of an economic crime.

Should the reorganisation plan not be approved by the insolvency court, the reorganisation converts into a bankruptcy procedure.

Under reorganisation plans, unsecured creditors are usually paid a certain percentage of their claims, or are offered a share in the company. Secured creditors are usually paid the whole amount of their claims, or, more precisely, consideration corresponding to the value of collateral determined in an obligatory expert's report. All pre-insolvency claims against the debtor, even if not lodged in insolvency proceedings, cease to exist once the reorganisation plan comes into effect, unless otherwise specified.

A reorganisation procedure is concluded upon the fulfilment of the reorganisation plan or its substantial parts (as a result of which the insolvency proceedings are terminated), or when the reorganisation is converted into a bankruptcy procedure by the insolvency court (in which case, insolvency proceedings continue until all of the debtor's assets are liquidated).

The Insolvency Act also provides for an expedited procedure: the so-called 'pre-packaged' reorganisation. If the debtor submits to the insolvency court a reorganisation plan that is pre-agreed by a majority of both secured and unsecured creditors when filing for insolvency, the insolvency court will permit the reorganisation already when ruling on the debtor's insolvency, provided other conditions are met. This significantly expedites (by several months) the reorganisation procedure, as the insolvency resolution method would otherwise be voted on at the first creditors' meeting, which takes place usually three months after the insolvency decision.

6.2 Position of the Company During Procedures

The company (debtor) has a crucial position in the reorganisation, as it is usually the debtor who files for reorganisation and submits a reorganisation plan. Clearly, the owners of the company wish to continue their business (or sell their business) rather than undergo the liquidation of their assets. As reorganisation is effectuated within formal insolvency proceedings, no claims against the company may be enforced outside reorganisation.

Throughout reorganisation procedures, the company (debtor) stays in possession of its assets, administers and disposes of its assets, and continues its business activities. The company's activities are supervised by the insolvency trustee, the creditors' committee and the insolvency court.

Current directors may continue to manage the company during reorganisation. The powers of the general meeting (shareholders) are transferred to the insolvency trustee, except for the appointment and removal of directors and supervisory board members, which is, however, subject to the consent of the creditors' committee.

6.3 The Roles of Creditors During Procedures

Under reorganisation plans, creditors are divided into classes based on the similarity of their legal position and interests. Each secured creditor forms a separate class; unsecured creditors may form one or more classes (eg, financial creditors, trade creditors, bondholders, etc). Reorganisation plans are subject to the vote of each class of creditors defined therein; they are accepted by a class of creditors if agreed by an absolute majority of both the creditors with voting rights falling in such class and the total number of votes in such class (votes are assigned according to the amount of the acknowledged claims – one crown, one vote). Creditors falling into the same class shall have the same rights and receive the same satisfaction under reorganisation plans.

Creditors are organised into creditors' bodies – meetings of creditors and creditors' committees – regardless of whether a reorganisation or bankruptcy procedure is followed.

Creditors' meetings are the supreme body of all registered creditors (ie, creditors with priority claims are not included), which appoints and removes members of the creditors' committee and decides on all important matters in insolvency proceedings. In most cases, decisions are adopted by an absolute majority of votes of present creditors with voting rights.

Creditors' committees are made up of three to seven registered creditors, with both secured and unsecured creditors being represented. Members are obliged to act with professional care and they bear corresponding responsibility. Their fees and expenses are paid out of the insolvency estate (priority claims). Creditors' committees shall advance the common interest of the creditors, supervise the activities of the insolvency trustee and give necessary consent where required under the Insolvency Act.

6.4 Modification of Claims

Creditors' claims may be modified by a reorganisation plan, even if said creditors are in the minority that voted against it. If any class of creditors does not accept a reorganisation plan, the court may still approve it if at least one class did accept it and if the plan is fair to the creditors. It follows that a reorganisation plan may succeed even if only one secured creditor (eg, a bank) supports it, or even against the will of secured creditors if a class of unsecured creditors accepts it. It is presumed that the plan is fair to the creditors if their profit thereunder is higher than it would be in bankruptcy. Secured claims are satisfied in the value of the collateral and

unsecured claims are satisfied in their nominal value or less, provided that claims subordinated to unsecured claims are not satisfied at all.

Once the reorganisation plan is approved by the court, it is binding on all creditors, including dissenters, and their claims and rights shall be modified accordingly.

6.5 Trading of Claims

Claims may be traded throughout insolvency proceedings, including reorganisations, without limitation. If a creditor transfers its claim to another person, the court shall, based on a motion of the transferor, allow the transferee to enter into the insolvency proceedings in place of the transferor, with the same rights and obligations.

6.6 Using a Restructuring Procedure to Reorganise a Corporate Group

The Insolvency Act does not provide for special provisions that would allow the reorganisation of a corporate group on a combined basis; insolvency proceedings with respect to each company from the same group have to be commenced and conducted separately. However, the same insolvency trustee shall be installed in all such proceedings (unless there is a conflict of interest), which may significantly facilitate and expedite the reorganisation procedure of group members.

6.7 Restrictions on the Company's Use of or Sale of Its Assets During a Formal Restructuring Process

After the commencement of insolvency proceedings, the company (debtor) is only allowed to use and sell its assets within the ordinary course of business, otherwise the consent of the insolvency court is required. Once a reorganisation is allowed, all previous restrictions cease to operate; however, the debtor is obliged to obey the approved reorganisation plan and refrain from any acts that might thwart its fulfilment. Moreover, fundamental decisions and dispositions may be taken only with the consent of the creditors' committee.

6.8 Asset Disposition and Related Procedures

In reorganisations, debtors have the right of disposal over the insolvency estate. After a reorganisation plan comes into effect, the debtor may realise its assets in accordance with the reorganisation plan under the supervision of the insolvency trustee and the creditors' committee. Purchasers acquire disposed assets free of any claims and/or security interests.

Sales and similar transactions that have been pre-negotiated prior to a reorganisation (or the opening of insolvency proceedings) may be effectuated only if such transaction is included in the reorganisation plan. There are no restrictions on the purchase of assets from the insolvency estate by creditors, except members of the creditors' committee who need the consent of a creditors' meeting.

6.9 Release of Secured Creditor Liens and Security Arrangements

Secured creditors and third-party liens and security over the debtor's assets shall be released once a reorganisation plan comes into effect, unless otherwise specified. New security may be created under the reorganisation plan, especially in favour of the original secured creditors.

6.10 Availability of Priority New Money

Priority new money is usually injected by secured creditors (who have a preferential right to provide the debtor with loan financing) or an external investor. New money is in no case encumbered by existing security. The debtor may enter into an agreement on loan financing only with the prior consent of the creditors' committee. Claims arising from such agreements shall have the status of priority claims and be satisfied preferentially at any time after an insolvency decision (please see **5.8 The Statutory Waterfall of Claims** and **5.9 Priority Claims**).

6.11 Statutory Process for Determining the Value of Claims

All registered claims are subject to review, at a review hearing, as to their existence, registered amount and/or priority. If they are fully/partially denied by the insolvency trustee and/or the debtor, their existence, amount and/or priority will be ultimately decided by the insolvency court. Reorganisation plans create a reserve for the potential satisfaction of contested claims.

6.12 Restructuring or Reorganisation Plan or Agreement Among Creditors

A reorganisation plan needs to be approved by the insolvency court. If the plan is not accepted by all classes of creditors, the court assesses the overall 'fairness' of the plan pursuant to general assumptions laid down in the Insolvency Act (please see **6.4 Modification of Claims**).

6.13 The Ability to Reject or Disclaim Contracts

If a contract is not fully fulfilled by either the debtor or the other party at the time of the commencement of a reorganisation, the debtor may reject the performance of such contract within a 30-day period, on the condition of the consent of the creditors' committee. In such a case, the other party may claim compensation for damage caused, but no later than 30 days after the date of rejection.

6.14 The Release of Non-debtor Parties

After a reorganisation plan comes into effect, all pre-insolvency rights and claims of all creditors against the debtor shall cease to exist, as a rule. On the contrary, liabilities of non-debtor parties persist throughout the reorganisation, unless otherwise specified in the reorganisation plan.

6.15 Creditors' Rights of Set-off, Off-set or Netting

The mutual claims of the debtor and its creditors can generally be set off (under certain conditions provided by the Insolvency Act) after the commencement of insolvency proceedings, until a motion for reorganisation is published on the insolvency register. Thereafter, set-offs are not permissible unless the insolvency court determines otherwise by a preliminary measure. This ban terminates once a reorganisation plan comes into effect.

6.16 Failure to Observe the Terms of an Agreed Restructuring Plan

If the debtor fails to fulfil a reorganisation plan or a substantial part of it, or ceases to pursue its business activity, the insolvency court shall decide on the conversion of the reorganisation into a bankruptcy procedure, as a result of which all assets of the debtor will be liquidated.

6.17 Receive or Retain Any Ownership or Other Property

Claims of equity owners resulting from their participation in the company (debtor) do not have to be lodged in insolvency proceedings. Such claims are only reported to the insolvency trustee. In reorganisations, such claims are equal to zero, by law, and will thus not be satisfied.

Equity owners may retain their ownership interests in the company and/or other property if so provided in the reorganisation plan.

7. Statutory Insolvency and Liquidation Proceedings

7.1 Types of Statutory Voluntary and Involuntary Insolvency and Liquidation Proceedings

Bankruptcy is one of three ways of dealing with the debtor's insolvency under Czech law (in addition to reorganisation and debt clearance), and is the only one of a universal character. No specific conditions are required by the Insolvency Act to commence bankruptcy procedures. Thus, bankruptcy shall always take place when the reorganisation of a company is not permissible under the Insolvency Act, when a reorganisation plan is not approved by the insolvency court, or when the creditors simply prefer bankruptcy to reorganisation (by a required majority of votes). Should the debtor not fulfil its duties under an approved reorganisation plan or if such plan cannot be fulfilled, the insolvency court will convert the reorganisation into bankruptcy.

As is the case for reorganisations, bankruptcy procedures take place within formal insolvency proceedings after the insolvency court has ruled on the debtor's insolvency, so general rules regarding insolvency proceedings apply (eg, creditors have to lodge their claims, as they cannot be enforced outside insolvency proceedings, etc). A bankruptcy procedure is commenced upon the declaration of a debtor's bankruptcy by the insolvency court. All court decisions and documents are officially published on the insolvency register.

The objective of the bankruptcy procedure is solely to liquidate assets belonging to the insolvency estate and proportionally distribute the proceeds among the creditors in order to satisfy their claims. In cases in which the debtor is a legal entity, bankruptcy always leads to the dissolution of the debtor, and the unsatisfied claims cease to exist.

From the moment of a bankruptcy decision, the debtor loses its right to manage and dispose of assets belonging to the estate, which right is transferred to the insolvency trustee. Creditors may exercise their rights only under the conditions provided by the Insolvency Act, and all undue claims against the debtor (with certain exceptions) become due and payable.

7.2 Distressed Disposals as Part of Insolvency/Liquidation Proceedings

The insolvency trustee shall proceed to liquidate the debtor's assets without undue delay, and distribute proceeds among creditors in accordance with the statutory waterfall of claims (please see **5.8 The Statutory Waterfall of Claims**). Purchasers acquire liquidated assets free and clear of any claims and/or security interests.

There are no restrictions on the purchase of assets out of insolvency estates by creditors, except members of the creditors' committee and related persons thereof. The debtor, its shareholders/members/controlling persons, leading personnel and companies belonging to the same group are not allowed to purchase the debtor's assets, nor may such assets be transferred to them from third persons prior to the end of a three-year period after the termination of a bankruptcy; such transfers shall be null and void unless they were allowed by the insolvency court.

7.3 Implications of Failure to Observe the Terms of an Agreed or Statutory Plan

In reorganisations, if the debtor fails to fulfil a reorganisation plan, the insolvency court shall decide on the conversion of the reorganisation into a bankruptcy procedure. No such plan is prepared in bankruptcy; the right of disposal over the insolvency estate passes from the debtor to the insolvency trustee, who is obliged to proceed to liquidate assets in the shortest possible time, to the maximum satisfaction of creditors.

7.4 Investment or Loan of Priority New Money

During bankruptcies, the debtor is generally not provided with loan financing, since the whole process aims to liquidate the debtor's assets and terminate its business activities. However, the debtor (prior to a bankruptcy decision) or the insolvency trustee (following a bankruptcy decision) may

arrange for interim funding in order to secure the business operation until the enterprise is sold. Loan financing is provided under the same conditions as in reorganisations (please see **6.10 Availability of Priority New Money**).

7.5 Insolvency Proceedings to Liquidate a Corporate Group on a Combined Basis

The Insolvency Act does not provide for special provisions that would allow the liquidation of corporate groups on a combined basis; insolvency proceedings with respect to each company from the same group have to be commenced and conducted separately. However, the same insolvency trustee shall be installed into all such proceedings (unless there is a conflict of interest), which may significantly facilitate and expedite the bankruptcy procedure.

7.6 Organisation of Creditors

Please see **6.3 The Roles of Creditors During Procedures**.

7.7 Conditions Applied to the Use of or Sale of Assets

Although insolvency trustees have the right of disposal over insolvency estates in bankruptcy, the liquidation of assets is subject to various consents of the creditors' committee and the insolvency court.

Insolvency trustees most often proceed to liquidate debtors' assets by way of public auction or direct sale. In each case (in relation to each asset individually), the specific method is subject to the consent of the creditors' committee. Otherwise, direct sales are subject to the approval of the insolvency court. As regards assets that serve as collateral for secured claims, the insolvency trustee shall proceed in accordance with the binding instructions of secured creditors as to both the maintenance and realisation of an asset.

For more details, please see **4 Secured Creditor Rights and Remedies** and **5 Unsecured Creditors Rights, Remedies and Priorities**).

8. International/Cross-border Issues and Processes

8.1 Recognition or Other Relief in Connection with Foreign Restructuring or Insolvency Proceedings

Insolvency proceedings opened in another Member State of the European Union are recognised in the Czech Republic in accordance with the EU Insolvency Regulation. In respect of insolvency proceedings opened in non-EU countries, Czech Act No 91/2012 Coll., on International Private Law (hereinafter the 'International Private Law Act'), provides that foreign judgments rendered on insolvency proceedings are recognised in the Czech Republic on the condition of reciprocity, provided that the centre of the debtor's main interests is situated in the foreign country that issued the judgment, and that the debtor's assets located in the Czech Republic have not been subject to insolvency proceedings already commenced before Czech courts.

8.2 Protocols or Other Arrangements with Foreign Courts

The EU Insolvency Regulation provides a general framework for mutual co-operation and communication between insolvency trustees and insolvency courts across the European Union, in order to facilitate the co-ordination of cross-border insolvency proceedings concerning the same debtor. Such co-operation may take any form, including the conclusion of agreements or protocols. In addition, bilateral treaties and soft law regulations such as the UNCITRAL Model Law on Cross-Border Insolvency and other similar guidelines also apply.

8.3 Rules, Standards and Guidelines to Determine the Paramountcy of Law

It is a general principle of law that all proceedings shall be governed by the laws of the state within the territory of which such proceedings are opened. In relation to insolvency proceedings opened in EU Member States, this principle is specified in Section 7 para. 1 of the EU Insolvency Regulation. At the same time, Section 3 para. 1 of the EU Insolvency Regulation provides that insolvency proceedings shall be opened in the Member State in which the centre of the given debtor's interests is situated. Pursuant to Section 111 para. 3 of the International Private Law Act, the above-mentioned conflict-of-law rules laid down in the EU Insolvency Regulation shall apply similarly in relation to non-EU Member States.

8.4 Foreign Creditors

Essentially, foreign creditors are treated equally to domestic creditors under Czech law, in compliance with the principle of the equal treatment of creditors. For more information, please see **4.4 Special Procedures or Impediments That Apply to Foreign Secured Creditors**.

9. Trustees/Receivers/Statutory Officers

9.1 Types of Statutory Officers Appointed in Proceedings

The key person in each insolvency proceeding is the insolvency trustee appointed by the insolvency court in the insolvency decision. Before this, the insolvency court may appoint a preliminary trustee while, at the same time, defining the trustee's powers and duties. This step usually relates to a concurrent adoption of interim measures and/or a large extent of the insolvency estate. The preliminary trustee is then usually appointed the (regular) insolvency trustee of the debtor.

Additionally, a separate insolvency trustee may be appointed should the (regular) insolvency trustee be excluded from the exercise of certain duties due to a conflict of interest, which, at the same time, does not prevent him from the exercise of his other powers and duties in the insolvency proceedings.

9.2 Statutory Roles, Rights and Responsibilities of Officers

The insolvency trustee is particularly obliged to survey and make inventory of the debtor's assets (insolvency estate), draw up a list of registered claims and review any such claim, as a result of which the insolvency trustee either acknowledges the claim as existing in the registered amount with the registered priority or fully/partially denies the claim as to its existence, amount and/or priority. Creditors of denied claims may then seek the acknowledgement of their claims (as to their existence/amount/priority) by the insolvency court in a special incidental dispute. In bankruptcy, the right to manage insolvency estates passes from the debtor to the insolvency trustee, who is obliged to proceed to liquidate assets in the shortest possible time, to the maximum satisfaction of creditors. Otherwise, debtors stay in possession of their assets in insolvency proceedings and are entitled to any action falling within the ordinary operation of its business.

Insolvency trustees are obliged to exercise their duties with conscientious and professional care, to the highest possible satisfaction of the creditors. If they breach this duty, they shall be liable for any damage caused to the debtor, creditors or third parties, and the insolvency court may dismiss such trustee even without a special proposal. Trustees may also be relieved from office by the insolvency court for reasons other than a breach of their duties (eg, health reasons).

9.3 Selection of Statutory Officers

Insolvency trustees are appointed by the insolvency courts from an official list by way of rotation. In pre-packaged reorganisations, debtors have the right to choose the insolvency trustee, as the insolvency court shall appoint the trustee nominated in the reorganisation plan, provided other statutory conditions are met (no conflict of interests, etc). When it comes to the insolvency of several companies belonging to the same group, the same trustee shall be appointed for all such companies, if possible. Insolvency trustees of debtors that are undergoing reorganisation or that are financial institutions or large companies must have a special authorisation.

9.4 Interaction of Statutory Officers with Company Management

A debtor's management is obliged to provide the insolvency trustee with maximum co-operation as well as any requested information and documents relating to the debtor. In reorganisations, the insolvency trustee supervises the activities of the debtor's directors and other managers, as the debtor retains possession of its assets (unlike bankruptcy).

9.5 Restrictions on Serving as a Statutory Officer

In order to become an insolvency trustee, a person must be a graduate of a Master's degree programme, and must have a clean criminal record and at least three years of professional experience. Such person must have passed an insolvency exam, concluded a liability insurance agreement and possess appropriate personal and material equipment. Persons who fulfil all of the statutory conditions are registered in the official list of insolvency trustees maintained by the Ministry of Justice.

Creditors, owners and directors of the debtor, and their representatives, may not be appointed the insolvency trustee of the debtor, due to a clear conflict of interest. Restructuring professionals, attorneys, accountants or other professionals may serve as insolvency trustees if they are registered on the list of insolvency trustees and do not have a conflict of interest in the particular case.

10. Advisers and Their Roles

10.1 Types of Professional Advisers

It is common practice in Czech insolvency proceedings for insolvency trustees and creditors' committees to engage professional advisers, especially legal and economic (tax) advisers. Legal advisers often represent the trustee in incidental and other legal disputes, or assist on complex issues requiring specific legal analysis. Economic advisers provide various expert opinions and analyses (eg, dealing with the economic feasibility of reorganisation), and assist with the preparation of financial plans and statements. Debtors tend to employ legal and economic advisers as well, especially for the legal representation in proceedings and preparation of insolvency petitions, reorganisation plans and other complex documentation.

10.2 Authorisations Required for Professional Advisers

There are no mandatory judicial approvals required for the employment of professional advisers. However, as trustees are obliged to act with conscientious and professional care, they are liable for any damage caused by such professional advisers. The costs of professional advisers may be paid out of the insolvency estate, given the prior consent of the creditors' committee.

10.3 Roles Typically Played by the Various Professional Advisers

Please see **10.1 Types of Professional Advisers**.

11. Mediations/Arbitrations

11.1 Use of Arbitration/Mediation in Restructuring/Insolvency Matters

Generally speaking, arbitration clauses are widely used in the Czech market, including in out-of-court restructurings, since arbitration proceedings are much faster and less formalised than ordinary judicial processes, and therefore also much cheaper. However, arbitration has no place in insolvency proceedings, as these are obligatorily held before insolvency courts.

Mediation is used more frequently in civil disputes (family and neighbour issues) rather than business or restructuring matters, and less so in insolvency matters.

11.2 Parties' Attitude to Arbitration/Mediation

Please see **11.1 Use of Arbitration/Mediation in Restructuring/Insolvency Matters**.

11.3 Mandatory Arbitration or Mediation

Courts do not order mandatory arbitration or mediation in insolvency proceedings. The same applies to restructurings, which are informal out-of-court processes without court interference under Czech law.

The insolvency of debtors shall be dealt with only in insolvency proceedings before insolvency courts. Once insolvency proceedings have been commenced, creditors have to lodge their claims against the debtor in insolvency proceedings, and arbitration clauses are without effect.

11.4 Pre-insolvency Agreements to Arbitrate

Under the Insolvency Act, creditors are not entitled to enforce their claims outside insolvency proceedings once such proceedings are commenced, which also fully applies to the enforcement in arbitration proceedings. However, should the debtor or its insolvency trustee enforce debtor's claims arising under a pre-insolvency agreement, they need to comply with any applicable arbitration clause.

11.5 Statutes That Govern Arbitrations and Mediations

Under Czech law, the agenda of arbitrations and mediations is governed primarily by Act No 216/1994 Coll., the Arbitration Act, Act No 202/2012 Coll., the Mediation Act, and the Private International Law Act. Parties may also choose other rules to govern their arbitration proceedings, such as the UNCITRAL Arbitration Rules. The New York Convention applies in relation to the recognition and enforcement of foreign arbitral awards.

11.6 Appointment of Arbitrators/Mediators

The contracting parties usually determine the number of arbitrators as well as the arbitrators themselves in an arbitration clause, or at least the manner of such determination. Otherwise, as the Arbitration Act provides, each party appoints one arbitrator, and such appointed arbitrators appoint the presiding one. Should the parties not appoint an arbitrator or if the arbitrators cannot agree on the presiding arbitrator, the arbitral institution will appoint the arbitrator or arbitral tribunal itself, from the official list.

As for mediation, the parties can jointly choose a mediator from the official list of mediators maintained by the Ministry of Justice, or another person they agree on. In some cases (typically in civil proceedings), mediation may be ordered by the court and, if the parties cannot agree on a mediator, the court will appoint the mediator itself from the official list.

According to the Arbitration Act and Private International Law Act, arbitrators can be Czech citizens as well as foreigners who have full legal capacity and a clean criminal record. There are no legal requirements as to the adequate (legal) education of the arbitrators. However, only persons who have graduated from university with a Master's degree in law may be entered into the official list of arbitrators maintained by the Ministry of Justice.

The Mediation Act requires mediators, inter alia, to have graduated from university with (at least) a Master's degree and to have passed a mediator exam in order to be entered into the official list of mediators maintained by the Ministry of Justice. The Ministry of Justice also supervises the compliance of registered mediators with the Mediation Act.

12. Duties and Personal Liability of Directors and Officers of Financially Troubled Companies

12.1 Duties of Officers and Directors of a Financially Distressed or Insolvent Company

In general, members of company bodies (including directors) are obliged to act with due managerial care, which includes aiming for the prevention of insolvency, or filing for insolvency in due time.

According to the Insolvency Act, directors of a company are obliged to file an insolvency petition without undue delay after they learn or should have learned (while acting with due care) about a company's (actual) insolvency. If directors fail to file for insolvency in due time, each of them shall be personally liable for damages or other loss caused to the affected creditors (for more details please see **2.5 Liabilities, Penalties or Other Implications for Failing to Commence Proceedings**).

According to the Business Corporations Act, if directors knew or could have known about an imminent insolvency of the company and breached their duty to act with due care (ie, did not do everything necessary and reasonably fore-

seeable to avert insolvency), they may be obliged to return consideration or other benefits received from the company within two years preceding the insolvency decision (Section 62 of the Business Corporations Act). Moreover, such directors may be expelled from their offices and prohibited from becoming and acting as a director of any company for a period of three years by the insolvency court (Section 63 et seq of the Business Corporations Act). Ultimately, a court may decide upon request of the insolvency trustee or affected creditor that such directors guarantee the payment of pre–insolvency debts of the company (Section 68 of the Business Corporations Act).

In reorganisations, if the debtor disposes of its significant assets without the prior consent of the creditors' committee, directors shall be jointly and severally liable for damage caused to affected creditors and third parties.

Subject to certain conditions, directors who breach their duties and/or jeopardise the purpose of insolvency proceedings may face criminal prosecution, in particular under Section 220–225 of Act No 40/2009 Coll., the Criminal Act.

12.2 Direct Fiduciary Breach Claims

In cases of breach of the director's duties referred to in **12.1 The Duties of Officers and Directors of a Financially Distressed or Insolvent Company**, affected creditors may assert direct claims against the directors.

12.3 Chief Restructuring Officers

The position of Chief Restructuring Officer is not recognised under Czech law. Nonetheless, large companies experiencing financial difficulties or insolvency do sometimes use professional crisis management to help them fix their adverse financial situation and/or undergo an out-of-court restructuring, or a formal reorganisation procedure within insolvency proceedings.

12.4 Shadow Directorship

Czech legislation does not specifically address the concept of shadow directorship. However, national law recognises the concepts of 'influential person' (ie, any legal or natural person who influences a company's action in any significant manner) and 'controlling person' (ie, a legal or natural person who can influence the company in a decisive manner; eg, a person who is able to appoint or dismiss a majority of members of statutory or supervisory bodies is deemed a controlling person), which have certain characteristics of shadow directors. Under conditions set out in Section 71 et seq of the Business Corporations Act, influential and controlling persons may be liable for damage caused to influenced/controlled companies.

12.5 Owner/Shareholder Liability

Generally, owners or shareholders of insolvent companies are not liable to creditors, in accordance with the separate legal entity principle. However, if they significantly influence or control a company and such influence/control results in a company's insolvency, a court may, upon request of the insolvency trustee or affected creditor, prohibit such owners or shareholders from becoming or acting as a director of any company for a period of three years, and/or even decide that they guarantee the payment of pre-insolvency debts of the influenced/controlled company (this is similar in the case of directors – please see **12.1 The Duties of Officers and Directors of a Financially Distressed or Insolvent Company**).

13. Transfers/Transactions That May Be Set Aside

13.1 Grounds to Set Aside/Annul Transactions

Within one year of the publication of an insolvency decision in the insolvency register, insolvency trustees may challenge legal acts or omissions of the debtor that result in the lower satisfaction of creditors and/or discriminate against certain creditors in favour of others.

Such legal acts or omissions are classified as voidable legal acts and shall be disregarded and have no effects in insolvency proceedings if they are successfully challenged by insolvency trustees. Persons in whose favour any consideration was provided by the debtor under such voidable legal acts must return the received consideration or, if not possible, must provide appropriate financial compensation to the insolvency estate.

13.2 Look-back Period

Legal acts without adequate consideration and advantageous legal acts may be challenged by insolvency trustees within a look-back period of three years (prior to the commencement of insolvency proceedings) if they were made in favour of an affiliated person of the debtor or a person that is a part of the same group as the debtor, otherwise in a period of one year.

If the debtor acted deliberately with the intention to lower the satisfaction of its creditors and the other party knew about such dishonest intention, the look-back period for setting aside such transactions in insolvency proceedings is five years.

13.3 Claims to Set Aside or Annul Transactions

Creditors are not allowed to bring claims to set aside transactions in insolvency proceedings, which is the exclusive right of insolvency trustees. These claims may be brought in reorganisations as well as in bankruptcy.

14. Intercompany Issues

14.1 Intercompany Claims and Obligations

As a rule, intercompany claims (including claims of companies from the same group) are treated equally to third-party claims in insolvency proceedings, in compliance with the principle of the equal treatment of creditors. Intercompany creditors have to lodge their claims in insolvency proceedings (except for claims of shareholders or members of the debtor arising from their participation in the company, such as dividends).

Despite receiving, generally, the same treatment as third-party claims, rights of intercompany creditors are subject to certain limitations. Intercompany creditors cannot vote at creditors' meetings (except for the voting on a reorganisation plan) or buy assets from insolvency estates. Moreover, voidable legal acts towards intercompany creditors may be opposed by insolvency trustees in much longer look-back periods than in the case of third-party creditors (please see **13 Transfers/Transactions That May Be Set Aside**).

14.2 Off-set, Set-off or Reduction

Intercompany claims may be set off in insolvency proceedings under the same conditions as third-party claims.

14.3 Priority Accorded Unsecured Intercompany Claims and Liabilities

Unsecured intercompany claims are treated equally to unsecured third-party claims in insolvency proceedings, and shall have the same priority.

The only exception applies in relation to the claims of shareholders or members of a debtor arising from their participation in the company, such as unpaid dividends. These claims do not need to be lodged in insolvency proceedings; their creditors only report to insolvency trustees that such claims exist. They have the lowest priority in insolvency proceedings and shall always be satisfied last in order. In practice, such claims are not usually satisfied at all.

14.4 Subordination to the Rights of Third-party Creditors

Please see **14.3 Priority Accorded Unsecured Intercompany Claims and Liabilities**.

14.5 Liability of Parent Entities

As parent companies and their subsidiaries (whether direct or indirect) represent individual legal entities, parent companies are not generally liable for the obligations of their subsidiaries, unless they have agreed otherwise.

14.6 Precedents or Legal Doctrines That Allow Creditors to Ignore Legal Entity Decisions

Please see **12.5 Owner/Shareholder Liability**.

14.7 Duties of Parent Companies

Parent companies are obliged to provide insolvency trustees with all possible co-operation in relation to the determination of assets belonging to the insolvency estates of their subsidiaries. Parent companies do not have any other specific duties in relation to subsidiaries or their creditors in insolvency proceedings (but please see **12.5 Owner/Shareholder Liability**).

14.8 Ability of Parent Company to Retain Ownership/Control of Subsidiaries

Parent companies may retain ownership of a subsidiary in insolvency proceedings. In cases of bankruptcy, the subsidiary is liquidated and dissolved once the insolvency proceedings are finished. In cases of reorganisation, parent companies retain their ownership even after the insolvency proceedings, unless the company is sold or the ownership is otherwise transferred under a reorganisation plan. Ownership interests may also be lowered due to equity-debt swaps.

15. Trading Debt and Debt Securities

15.1 Limitations on Non-banks or Foreign Institutions

Generally speaking, no limitations are imposed on non-banks or foreign institutions with respect to the holding or provision of loans to the extent that doing so does not represent their main business activity (ie, repeated activity with the aim of generating profit). In such cases, the loan provider must obtain specific authorisation from the Trade Licensing Office. Certain restrictions have been adopted regarding consumers, as only specific institutions holding a licence from the Czech National Bank are allowed to provide consumer loans.

Separately, intra-group loan financing does not fall under this regulation.

15.2 Debt Trading Practices

The content of customary documentation in the Czech Republic depends on the type of financing and the number of participating banks. Banks usually use their own internal documentation for bilateral loans, or ask external legal firms to draft it. If there are more participating banks, or if a foreign bank is involved, or if the provided loan is relatively substantial, LMA standards (governed by UK law) or their main characteristics (adapted to Czech law) are frequently used. Moreover, the Czech Banking Association provides its members with standard loan documentation.

The mechanism for the transfer of receivables or rights and obligations stemming from facility agreements is usually the assignment of the receivable or facility agreement itself. Banks and other financial institutions also use sub-participation. Novation is generally avoided as it represents a change

of the obligation per se, so its nature does not fulfil the sense of transfer mechanisms.

In accordance with the general rules for the assignment of receivables, the assignee acquires the receivable's accessories as well as related rights, including its security (such as pledge, financial guarantee, contractual penalty, etc).

Incorporating a confidentiality clause into facility agreements is standard practice in Czech business, but it does not address insider trading. As the Czech Republic is a Member State of the European Union, the Market Abuse Regulation (MAR) applies. In addition to MAR, national law (ie, the Capital Markets Act) establishes a duty on persons to whom MAR applies to implement, maintain and apply a mechanism to report MAR violations or threats of such violation.

15.3 Loan Market Guidelines

There are several organisations that possess the status of associate of the LMA, such as the Czech Export Bank or Home Credit International a.s. As such, these organisations are governed by the LMA guidelines.

However, as the LMA guidelines are not an integral part of national law, they are not binding in the Czech Republic, but contractual parties may agree on such binding effect, deeming its breach a breach of contractual obligation.

15.4 Enforcement of Guidelines

Please see **15.3 Loan Market Guidelines**.

15.5 Transfer Prohibition

Questions regarding the possibility of transfer and related restrictions are subject to the negotiation strengths of the relevant party. As debtors typically want to control who is their creditor, clauses prohibiting transfers to trusts or other private institutions are usually included in facility agreements. Therefore, facility agreements usually contain a clause that authorises creditors to transfer their rights and duties to affiliates or third parties if they are banks seated within the European Union or banks holding a specific rating without the debtor's consent. In cases of continuing events of default, creditors are usually allowed to make transfers or assignments to any third party without the debtor's consent as well.

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15.6 Navigating Transfer Restrictions

Please see **15.5 Transfer Prohibition**.

16. The Importance of Valuations in the Restructuring and Insolvency Process

16.1 Role of Valuations in the Restructuring and Insolvency Market

In Czech insolvency proceedings, an expert valuation of a debtor's insolvency estate must always be made in reorganisations. In particular, an expert shall valuate each asset that serves as collateral for secured claims separately because, as a rule, reorganisation plans may only be approved if each secured creditor receives consideration thereunder, at least in the value of the collateral. The overall value of an insolvency estate is determinative for the assessment of whether creditors' claims are satisfied to a greater extent than they would probably be in bankruptcy, which is another statutory condition for the approval of reorganisation plans by the insolvency court.

In bankruptcy, a valuation of a debtors' insolvency estate is required under the Insolvency Act only if such debtor's enterprise is to be sold as a whole, pursuant to a decision of the creditors' meeting. Such valuation serves as information for insolvency trustees in tender processes.

Valuation reports shall be approved by a qualified two-thirds majority of creditors present at the creditors' meeting (calculated with reference to the value of claims). Once valuation reports are approved by the creditors, the insolvency court decides on the price of the insolvency estate accordingly. If the report is not approved, the creditors' meeting may appoint another expert to draw up a new valuation report.

16.2 Initiating Valuation

When a valuation is required under the Insolvency Act, the insolvency court appoints an expert and assigns them the task without any further instruction. The parties' suggestions on who should be appointed as expert are not binding on the court. The court usually chooses a person from the official list of experts kept by the respective court.

16.3 Jurisprudence Related to Valuations

Debtors' assets are evaluated by a liquidation method, whereby experts assume that the operation of a debtor's business has been terminated and thus attach to each asset (separately) its liquidation value. This is very disputable and problematic, as it does not correspond to the main aim of reorganisation, which is the preservation of the debtor's business operation. As a result, the price of the insolvency estate is very likely to be set lower than it actually is, which correspondingly lowers the requirements as to the extent of satisfaction of creditors to be realised under a reorganisation plan.