ALLEN & OVERY

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Restructuring Across Borders

Czech Republic: corporate restructuring and insolvency procedures

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Introduction

Czech Republic restructuring and insolvency law was reformed at the beginning of 2008 and Act No. 182/2006 Coll., as amended, on insolvency and the manner of its resolution (the **Insolvency Act**) governs insolvency and restructuring proceedings. This reform introduced a "rescue culture" into the Czech Republic, making available for the first time in the Czech Republic, a reorganisation proceeding as a non-liquidation form of insolvency procedure. In 2017, the Insolvency Act was substantially amended. Among other changes, the amendment brings number a of changes to the discharge of debts regime and provides debtors with additional protection against frivolous insolvency petitions.

The three principal restructuring and insolvency regimes under Czech Republic law are:

- bankruptcy (*konkurs*);
- reorganisation (*reorganizace); and*
- discharge from debts (*oddlužení*).

Under the Insolvency Act the concept of a single gateway procedure applies in the Czech Republic.

Insolvency proceedings are commenced from the date of the delivery of the insolvency petition to the relevant insolvency court. In the first stage of the proceedings, the court will examine whether the debtor is insolvent or threatened by insolvency. In the second stage, the court will primarily decide on the manner of resolving the debtor's insolvency (bankruptcy, reorganisation, or discharge from debts). In reaching this decision the court will largely be bound by the decision of creditors taken at a creditors' meeting. As a general rule, the court must issue this decision within three months after having declared the debtor insolvent. In accordance with the chosen manner of resolution of the debtor's insolvency, the insolvency proceedings will then continue as either bankruptcy proceedings, reorganisation proceedings or discharge from debts.

The purpose of the insolvency proceedings is to resolve the debtor's insolvency or threatened insolvency through the appropriate insolvency/restructuring proceedings so as to: (i) arrange the debtor's proprietary relations to persons affected by the debtor's insolvency or threatened insolvency; and (ii) satisfy the debtor's creditors to the greatest possible extent and generally on a pro rata basis.

Either the debtor itself or its creditors (and the relevant supervisory authority in the case of a bank, savings and credit co-operative or an insurance or reinsurance company after it has lost its licence, or securities trader, as well as persons subject to Act No. 374/2015 Coll., on recovery measures and crisis solution, implementing the Directive 2014/59/EU into Czech law, including financial institutions, financial holding companies, mixed financial and mixed-activity holding companies) has the right to file a petition for the initiation of insolvency proceedings. However, once a corporate debtor has discovered, or should have discovered if acting with due care, that it is insolvent, the debtor is obliged to file for its own insolvency without undue delay. The debtor's directors have the same (independent) duty. In addition, the debtor (but not its creditors) has a right to file an insolvency petition once it is threatened by insolvency.

Unless the insolvency court has reasonable doubts concerning the grounds of the insolvency petition, it must publish a notice of the initiation of insolvency proceedings in a publicly accessible insolvency register within two hours of the receipt of the insolvency petition. However, if the insolvency petition is delivered to the insolvency court outside of its business hours (or less than two hours before the end of its business hours) the publication deadline is two hours from the commencement of the insolvency court's business hours on the following business day. If the insolvency court has doubts concerning the grounds of the insolvency petition, it may decide not to publish the notice in the insolvency register and examine the merits of the

petition first in cooperation with the debtor and the petitioner. Consequently, it may either dismiss the petition or, publish the notice of the initiation of the insolvency proceedings in the insolvency register, however, in any case no later than within seven days from the receipt of the insolvency petition.

Creditors may file their claims from the date of the initiation of insolvency proceedings. The insolvency court must place a notice in the insolvency register for creditors to file their claims (either together with the publication of the notice of the initiation of insolvency proceedings, or separately). The second notice for creditors to file their claims is published by the insolvency court as part of the decision declaring the debtor insolvent. At that stage, the insolvency court will set a two-month deadline for the filing of claims. Claims filed after the expiry of the deadline will be disregarded. Different rules apply for certain preferential creditors (including the debtor's employees) who do not file their claims but exercise their claims directly against the insolvency administrator and for creditors of banks, savings and credit co-operatives following the revocation of their respective licences, securities traders, and persons subject to Act No. 374/2015 Coll., on recovery measures and crisis solution, including financial institutions, financial holding companies, mixed financial and mixed-activity holding companies, and insurance and reinsurance companies, whose claims are considered filed in the amount set out in the debtor's books.

Creditors may adopt important decisions in creditors' meetings, including: (i) the decision on the manner of resolving the debtor's insolvency; or (ii) the decision to remove the insolvency administrator appointed by the insolvency court and appoint a new insolvency administrator in his place, provided that the debtor is a corporate entity or natural person - entrepreneur. Creditors who have filed their claims (**Registered Creditors**) may participate and vote in the creditors' meetings. Their voting power depends on the value of their claims. Even if the Registered Creditor disputes the validity of another creditor's claim or the validity of the creditor's claim is disputed by the debtor, it has no effect whatsoever on voting rights of this creditor. On the other hand, if the validity of a creditor's claim is disputed by the administrator, the creditor may only vote if their voting right is approved at the creditors' meeting; if the creditors' meeting fails to approve the creditor's voting right, the creditor can ask the insolvency court for a final adjudication of the matter.

Where there are more than 50 Registered Creditors, the Registered Creditors (through a decision made in a creditors' meeting) must elect a creditors' committee (*věřitelský výbor*) to protect the creditors' common interest. The creditors' committee may have between three and seven members. The creditors' meeting may decide that each member will have an alternative member who can take the place of the member should that member not be able to attend a meeting. Both secured and unsecured creditors have the right to appoint an equal number of creditors' committee members. The members of the creditors' committee may be natural persons as well as corporate entities. Where there are 50 or fewer Registered Creditors, or in relation to small corporate debtors with turnover of less than CZK 2,000,000 (approximately €73,000) in the last accounting period, whose insolvency is resolved by negligible bankruptcy (*nepatrný konkurs*), the Registered Creditors may instead elect a creditors' representative (and an alternate representative). Among other tasks, the creditors' committee oversees the insolvency administrator's activities – for example, the creditors' committee may consent to the insolvency administrator or the debtor (if the debtor is allowed to deal with its assets) entering into certain types of new contracts as set out by the Insolvency Act and regularly approves the costs of the administration of the insolvent estate.

From the moment of publication of the notice of the initiation of insolvency proceedings in the insolvency register, and unless the insolvency court permits otherwise, the debtor must refrain from dealing with the insolvent estate in a way which could result in material changes to the composition, utilisation or determination of the assets or cause anything other than a negligible reduction in their value. The restriction does not, however, apply to the ordinary operation of the debtor's business. Nevertheless, the insolvency court may impose stricter limitations on the debtor by way of a preliminary measure, in which case the insolvency court will also appoint a preliminary administrator (*předběžný správce*).

As part of its decision declaring the debtor insolvent, the insolvency court will appoint an insolvency administrator (*insolvenční správce*). However, before declaring the debtor insolvent, the insolvency court may appoint a preliminary administrator (*předběžný správce*). A preliminary administrator is likely to be appointed in circumstances where the insolvent estate is large or if the insolvency court approved a moratorium.

To the extent that the debtor is prohibited by law or a decision of the insolvency court from dealing with the insolvent estate, this power is transferred to the insolvency administrator (or the preliminary administrator). The operation of the debtor's business continues in the insolvency proceedings and is managed either by the debtor itself (eg in reorganisation), or by the insolvency administrator. The insolvency administrator will also ascertain, examine, list and collect in the debtor's assets and scrutinise filed claims. The insolvency administrator's remaining tasks will depend on whether the debtor's insolvency will be resolved by bankruptcy, reorganisation or discharge from debts.

Bankruptcy (*konkurs*)

Bankruptcy is a stage of the single insolvency procedure which follows the initial examination of the debtor's insolvency and the insolvency court's decision on the manner of resolving the debtor's insolvency.

When the insolvency court declares the debtor insolvent it will also place it into bankruptcy proceedings if no other manner of resolving the debtor's insolvency is available. Generally, such a decision will be made within three months of the insolvency court declaring the debtor insolvent. Furthermore, even if the insolvency court initially decides that the debtor's insolvency is to be resolved by reorganisation or the discharge from debts, the proceedings may at a later state be converted into bankruptcy.

Following the declaration of bankruptcy, the right to deal with the insolvent estate is transferred to the insolvency administrator. Any subsequent legal acts of the debtor are ineffective vis-à-vis its creditors. The insolvency administrator's main tasks following the declaration of bankruptcy include ascertaining and securing the insolvent estate, finalising the list of filed claims, preparing the hearing for the examination of claims and preparing the creditors' meetings.

The insolvency administrator will continue the debtor's business until: (i) the insolvency court (pursuant to the insolvency administrator's petition and after hearing the creditors' committee) decides that the business should be ceased; or (ii) the insolvency administrator arranges for the sale of the business as a going concern pursuant to a single agreement. While continuing the debtor's business, the insolvency administrator will ascertain, examine, list and collect in the debtor's assets and sell those assets as either a going concern or on a piecemeal basis. The insolvency administrator will also scrutinise filed claims and distribute the proceeds to the creditors whose claims have been proven.

Once all of the proceeds from the liquidation of the insolvent estate have been distributed, the bankruptcy proceedings will be terminated by a court order. The termination of the proceedings does not have the effect of discharging the claims of creditors which have not been satisfied in full. However, in the case of a corporate debtor, bankruptcy will eventually result in the dissolution of the company, thus preventing later recourse to the debtor for payment of outstanding amounts. The Insolvency Act, therefore, provides that once a corporate debtor is dissolved following the termination of bankruptcy proceedings, the outstanding claims cease to exist unless they can be satisfied through the enforcement of security provided by third parties.

Reorganisation (*reorganizace*)

The aim of reorganisation proceedings is the eventual satisfaction of creditors' claims while the debtor's business continues in operation. This is achieved by measures intended to revitalise the economic operation of the debtor's business in accordance with a reorganisation plan approved by the insolvency court. The performance of the reorganisation plan is continuously monitored by creditors.

Reorganisation is available only to debtors involved in business activity and, as a general rule, only to those exceeding a certain size in terms of turnover generated in the last accounting period (CZK 50,000,000 (approximately EUR 1,800,000) or more) or the number of employees (50 or more). Reorganisation may not be used to resolve the insolvency or threatened insolvency of a corporate entity that has commenced a solvent liquidation, a securities trader, an entity licensed to trade on the commodity exchange, a bank, a savings and credit co-operative, an insurance or reinsurance company, a Czech branch of a non-EU bank or a Czech branch of a non-EU insurance company, persons subject to Act No. 374/2015 Coll., on recovery measures and crisis solution, including financial institutions, financial holding companies, mixed financial and mixed-activity holding companies.

The restriction on the availability of reorganisation proceedings to entities exceeding a certain size does not apply if the debtor submits to the insolvency court a reorganisation plan approved by the majority of secured and unsecured creditors calculated in accordance with the value of their claims.

The debtor or a Registered Creditor may apply for reorganisation, provided, however, that the applicant applies in good faith and all the requirements for the approval of the reorganisation plan are, or will be, met. Strict time limits apply for the filing for reorganisation. If the insolvency petition was filed by the debtor on the basis of a threatened insolvency, the debtor must apply for reorganisation before the insolvency court issues a decision declaring the debtor insolvent. In all other cases, reorganisation must be applied for not later than 10 days before the first creditors' meeting after the declaration of insolvency.

The insolvency court will first examine whether the application for reorganisation is admissible. The insolvency court will dismiss the application if, among other reasons, it may be justifiably presumed that, by filing for reorganisation, the applicant is pursuing a dishonest aim. If the insolvency court is satisfied that there are no reasons to dismiss the application, it will approve the application for reorganisation.

The debtor has a preferential right to submit the reorganisation plan (generally within 120 days of the insolvency court's decision approving the application for reorganisation). If the debtor does not submit the plan or waives its preferential right, the plan may be submitted by its Registered Creditors.
The reorganisation plan must contain, among other things: (i) the division of creditors into classes and determination of future treatment of their claims in these classes; (ii) the proposed method of reorganisation; (iii) measures for the implementation of the reorganisation plan and identification of the person authorised to deal with the debtor's assets; (iv) a statement as to whether the debtor's business will continue operation; (v) identification of the persons who will finance the reorganisation plan or who will assume some of the debtor's debts; (vi) a statement concerning how the reorganisation plan will affect the debtor's employees; and (vii) disclosure of what obligations, if any, the debtor will retain towards its creditors following the termination of reorganisation.

The reorganisation plan must be accepted by the creditors through their vote. For the purposes of voting on the reorganisation plan, the creditors will be divided into classes. Each class must comprise creditors with substantially the same legal status and economic

interests. Each secured creditor will form a separate class. Separate classes will also be formed of creditors whose claims will remain unaffected by the reorganisation plan (these creditors will not vote on the plan but will be deemed to have accepted it) and of the debtor's shareholders. For the reorganisation plan to be considered accepted by a class of creditors, it must be approved by a simple majority by number and 50% in value of claims of the creditors that took part in the voting in that class. To take effect, the reorganisation plan must be approved by the insolvency court. It should be noted that in certain circumstances, the insolvency court may approve the reorganisation plan even if it is not accepted by each class of creditors.

In the course of reorganisation, the debtor is generally authorised to dispose of and manage the property of the insolvent estate. However, the debtor will be supervised by the insolvency administrator and the creditors' committee. Prior consent of the insolvency administrator or the creditors' committee may be required for certain acts of the debtor.

As of the effective date of the reorganisation plan, the creditors' claims cease to exist (including claims that creditors failed to file) and only persons included in the reorganisation plan will be the debtor's creditors (under the terms contained in the reorganisation plan (including the value of their claims)).

Reorganisation terminates upon the issuance of a decision by the insolvency court in which the insolvency court acknowledges the satisfaction of the reorganisation plan. Reorganisation may, however, be converted into bankruptcy proceedings if, among other reasons, the relevant person fails to submit the reorganisation plan, the insolvency court does not approve the reorganisation plan, the debtor does not meet its obligations under the reorganisation plan or it becomes obvious that it will be impossible to perform a substantial part of the reorganisation plan.

Discharge from debts (*oddlužení*)

The purpose of the discharge from debts procedure is to resolve the insolvency of a corporate entity that is not involved in business activity and does not have debts from a business activity. Even if the debtor does have debts resulting from business activity, the debtor's insolvency may be resolved by discharge from debts if: (a) agreed by each creditor whose receivable is to be affected by the discharge from debts; (b) it concerns a receivable that remained unsatisfied following an insolvency proceeding in which the insolvency court terminated the debtor's bankruptcy proceedings by a court order either because (i) all of the proceeds from the liquidation of the insolvent estate had been distributed, or (ii) on the grounds that the debtor's assets were clearly insufficient to satisfy the debtor's creditors; or (c) it concerns a secured creditor's receivable.
Its purpose is to enable an honest but financially unsuccessful debtor to resolve its insolvency and, after satisfying its obligations under the approved manner of the discharge from debts, be freed from the remainder of its debts. In practice the discharge from debts process is used predominantly by natural persons, rather than any form of corporate entity.

European Insolvency Regulation

The EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) (the **Recast Regulation**) applies to all proceedings opened on or after 26 June 2017. Its predecessor, the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000) (the **Original Regulation**) continues to apply to all proceedings opened before 26 June 2017. One of the key changes in the Recast Regulation is that it brings into scope certain pre-insolvency "rescue" proceedings and these are now listed alongside the traditional insolvency procedures in Annex A to the Recast Regulation. The Recast Regulation retains the split between main and secondary/territorial proceedings but secondary proceedings are no longer restricted to a separate list of winding up proceedings - secondary proceedings can now be any of those listed in Annex A. By contrast, the Original Regulation listed main proceedings in Annex A and secondary proceedings (which were confined to terminal proceedings) in Annex B.

Of the above restructuring and insolvency regimes, bankruptcy (*konkurs*), reorganisation (*reorganizace*) and discharge from debts (*oddluženi*) were available as main proceedings under the Original Regulation. Only bankruptcy proceedings (*konkurs*) were available as secondary proceedings under the Original Regulation.

Under the Recast Regulation, bankruptcy (*konkurs*), reorganisation (*reorganizace*) and discharge from debts (*oddluženi*) are listed in Annex A.

Further information

For further information on Czech restructuring and insolvency procedures, we would refer you to the Sweet & Maxwell book "European Cross Border Insolvency" edited by Allen & Overy. To purchase a copy of this book, please visit www.sweetandmaxwell.co.uk

Allen & Overy has launched an online service for clients focusing on debt restructurings and insolvency issues. Developed by Allen & Overy's market-leading Restructuring group, "Restructuring Across Borders" is an easy to use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe and the US.

To request access for your organisation, please contact your usual Allen & Overy contact, or email rab@allenovery.com

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