

Global Restructuring & Insolvency Guide

Czech Republic

Overview and Introduction

The Czech Insolvency Code came into force on 1 August 2008 after the previous Bankruptcy Act, dated 1991, proved itself inadequate and out of date and it was decided to adopt a completely new and complex regulation.

The Insolvency Code is based on a concept of uniform insolvency proceedings. First of all, the Insolvency Code requires the competent court to decide whether or not the debtor is actually insolvent. Where the debtor is considered insolvent, the most appropriate way of dealing with insolvency is elected – which may be a bankruptcy, reorganisation, debt clearance, or other specific means in case of certain entities or situations. Insolvency proceedings differ in each case. The Insolvency Code is a unified code which governs insolvency proceedings, regardless of whether the debtor is an individual or legal entity, an entrepreneur or not.

This Guide is intended to be a general summary of the regime applicable in respect of insolvency proceedings under the Insolvency Code.

Applicable Legislation

Insolvency proceedings in the Czech Republic are primarily regulated by Act No. 182/2006 Coll., on Insolvency, as amended (the “**Insolvency Code**”). Related questions which are not addressed by the Insolvency Code are governed by Act No. 99/1963 Coll., on Civil Procedure, as amended (the “**Civil Procedure Code**”). Additionally, Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedings of the Council of the European Union is applicable in the Czech Republic. Additional laws may interact with the administration of an insolvent individual or corporations.

The Insolvency Code is applicable to debtors that are physical persons as well as to legal entities. The insolvency proceedings regime differs in some respects depending on whether the debtor is an entrepreneur or not.

Meaning of Insolvency

The insolvency proceedings described below are conducted only if the debtor is insolvent or insolvency is impending.

Insolvency

A debtor is insolvent if it is either illiquid or over-indebted.

A debtor (either an individual or a legal entity) is illiquid if it is unable to pay its debts as they fall due and:

- The debtor has more than one creditor;
- The debtor has due and payable monetary obligations which have been overdue for more than 30 calendar days; and
- The debtor is unable to satisfy such obligations (i.e. the debtor has suspended payments of a substantial portion of its monetary obligations, has defaulted with respect to payment of the same for more than three months past the due date, or is unable to satisfy certain due and payable obligations of the company by means of judicial enforcement).

- A debtor who is a legal entity or a natural person conducting business activity is further insolvent in case such debtor is over-indebted. The debtor is over-indebted when:
- It has more than one creditor; and
- The sum of its obligations exceeds the value of its assets.

When determining the value of the debtor's assets, a further management of the assets or a further operation of the debtor's business should be taken into consideration, provided that there is a justified presumption that, in light of the circumstances of the case, the debtor would be able to continue to manage its assets or operate its business ("going-concern assumption").

Impending Insolvency

Insolvency is impending on the debtor in cases where, taking into account all the circumstances of the case, it is reasonable to assume that the debtor would not be able to satisfy a substantial portion of its monetary obligations in a due and timely manner.

Insolvency Proceedings

Insolvency proceedings in the Czech Republic are always judicial proceedings held by a competent court ("**Insolvency Court**"), which makes decisions and oversees the entire procedure. The subjects participating in the proceedings include the debtor, creditors claiming their receivables, bodies representing the creditors (a creditors' meeting and creditors' committee, which is obligatory if the number of registered creditors reaches or exceeds 50), an Insolvency Court, and an insolvency administrator. The insolvency proceedings commence upon filing an insolvency petition by a legitimate person. Afterwards, the Insolvency Court decides whether the debtor is actually insolvent and, if so, which type of insolvency proceedings will be conducted.

The Insolvency Court always appoints an insolvency administrator. The insolvency administrator is a person possessing relevant professional expertise and qualifications who has passed a specialist examination and is listed by the Ministry of Justice.

Types of Insolvency Proceedings

Upon the declaration of the debtor's insolvency by the Insolvency Court, the insolvency is dealt with under one of the following types of insolvency proceedings:

- Bankruptcy;
- Reorganisation; or
- Debt clearance.

In cases of bankruptcy, the debtor's assets are sold and the creditors' claims are proportionally satisfied using the proceeds of the sale. Unsatisfied claims do not cease to exist, unless stipulated otherwise by the Insolvency Code. Bankruptcy always leads to a liquidation of a debtor that is a legal entity.

By reorganisation, the debtor's business is preserved and operated pursuant to an approved reorganisation plan under the supervision of the creditors. The creditors' receivables are paid off gradually.

Debt clearance is available only for debtors who are not entrepreneurs. By debt clearance, all due obligations of the debtor are extinguished subject to the conditions stipulated by the Insolvency Court conducting the proceedings.

The Insolvency Code also provides for special means of addressing the insolvency of special sorts of debtors, such as banks and other financial institutions.

Insolvency Court and Insolvency Petition

Insolvency proceedings can be commenced only by an insolvency petition. There is no need for the Insolvency Court to rule on the commencement of the insolvency proceedings. The insolvency petition must be filed with a competent regional court. Generally, the competent court is the court in the district where the debtor has its place of residence (in case of physical persons) or statutory seat (in case of legal entities); if the debtor is an entrepreneur, the competent court is the court in the district where the debtor has its registered place of business. The insolvency proceedings commence immediately after the insolvency petition is filed.

The insolvency petition must contain certain essentials prescribed by the Insolvency Code, including (but not limited to) the proper identification of the petitioner and the debtor, relevant facts proving the debtor's insolvency and the petitioner's entitlement to file the insolvency petition and supporting evidence.

Commencement of the Insolvency Proceedings

As mentioned above, the insolvency proceedings are commenced on the basis of an insolvency petition. The insolvency petition can be filed with the respective court by the debtor or any of its creditors. In case of impending insolvency, the insolvency petition can only be filed by the debtor. If the debtor is a legal entity, it is obliged to file an insolvency petition without undue delay after it has actually learned that it is insolvent, or after it should have learned of its insolvency if it had exercised due care.

Within hours after the insolvency petition is filed, the Insolvency Court publishes certain details of the just-commenced proceedings in the central web-based registry of insolvency proceedings.

By the commencement of the insolvency proceedings, the property of the debtor (an estate) is affected in many ways. First of all, any claims and rights pertaining to the assets of the estate may not be brought before a court by an action, but only by registration filed with the Insolvency Court. Secondly, the insolvency proceedings affect security interests established over the individual assets forming the debtor's property. Such security interests may only be enforced or established under the rules set forth by the Insolvency Code. Although any court may order judicial enforcement of a court decision relating to any assets of the debtor, such enforcement may not proceed while the insolvency proceedings are pending.

Furthermore, the debtor must keep ownership of its assets. It may not dispose of any assets pertaining to the estate if such disposal would diminish the value of the estate or substantially change the composition, utilisation or specification of the estate as a whole.

The debtor must also refrain from performing certain legal acts. The legal acts which would breach restrictions stipulated by the Insolvency Code would be ineffective in favour of the creditors. Hence, the creditors would be entitled to claim the ineffectiveness before a court. The restrictions relate mainly to the monetary obligations of the debtor incurred before the commencement of the insolvency proceedings, which may be performed only to the extent, and on the terms, set by the Insolvency Code. Generally, by way of example, the debtor may perform only those monetary obligations which are necessary to operate its business as usual and to avoid any impending losses.

First Phase of the Insolvency Proceedings

The immediate first phase of the insolvency proceedings is the time period between the filing of the insolvency petition and the decision of the Insolvency Court on that petition. Once the insolvency proceedings have commenced, the creditors may register their claims with the Insolvency Court.

Where the debtor is an entrepreneur, the Insolvency Code supports operating the debtor's business during this time period. The debtor carries on its regular business and continues paying the debts related to such regular business.

However, the debtor should not perform any acts which could be considered as preferential towards some of the creditors and to the detriment of others. Such preferential legal acts can be contested by

other creditors or by the insolvency administrator (who may be appointed by the Insolvency Court in the upcoming phase of the insolvency proceedings) and declared ineffective by the Insolvency Court.

The Insolvency Court may also, in order to prevent changes in the extent of the property of the estate which are detrimental to creditors, grant a preliminary injunction (with or without a motion), in which the Insolvency Court orders the debtor to refrain from disposing of certain things or rights forming a part of the estate. The Insolvency Court may further order persons owing obligations to the debtor not to render performance to the debtor, but to an interim insolvency administrator.

Optional Second Phase of the Insolvency Proceedings – Moratorium

A debtor who is an entrepreneur may, within seven days after filing the insolvency petition or within 15 days after the insolvency petition was filed by a creditor, file a motion with the Insolvency Court to grant a protection period: a moratorium. The Insolvency Court must then immediately decide on that motion. A moratorium period can be granted only if the majority of creditors (calculated according to the amounts of their claims) consents in writing to granting of such a protection period.

The moratorium granted by the Insolvency Court brings various consequences. For example, an agreement for supply of utilities and raw materials, or for supply of goods and services, may not be rescinded or withdrawn by the other party during the protection period because of a payment default by the debtor which occurred before the granting of the protection period, or because of any decrease in the total assets of the debtor. This restriction applies only if the debtor duly pays the amount that became due during the protection period or within 30 days before the granting of the protection period.

The protection period may be granted for a maximum period of three months and may be extended by up to 30 days if the majority of the creditors (calculated according to the amounts of their claims) consent in writing.

Third Phase of the Insolvency Proceedings – Ruling on Insolvency

The Insolvency Court must, within 10 days after filing of the insolvency petition, take necessary measures which will result in its decision. The Insolvency Court must decide on the insolvency petition immediately, in any case no later than 15 days after the filing, if the insolvency petition was filed by the debtor itself.

The Insolvency Court declares that the debtor is insolvent if the debtor or the creditor who filed the insolvency petition properly proves that the debtor is insolvent, or is threatened with insolvency. After ruling on insolvency, the Insolvency Court decides which type of insolvency proceedings will be conducted: it may be the bankruptcy of the debtor, reorganisation or debt clearance.

The Insolvency Court will appoint an insolvency administrator no later than the issuance of the ruling on insolvency. After the ruling on insolvency, the Insolvency Court invites the creditors of the debtor to register their claims with the court and requests persons who have any obligations towards the debtor to render any future performance of their obligations to the insolvency administrator instead of the debtor. Furthermore, the right to set off receivables against the estate of the debtor is restricted.

Bankruptcy

If the Insolvency Court declares bankruptcy over the debtor, the debtor loses its right to manage and dispose of assets belonging to the estate. This right is transferred to the insolvency administrator together with all the debtor's rights with respect to the estate. If the debtor does not adhere to these rules and performs any legal acts to which the debtor is not entitled, such legal acts will be ineffective *vis-à-vis* the debtor's creditors. The creditors would then be entitled to claim the ineffectiveness before a court.

The insolvency administrator, in particular:

- Exercises rights of the debtor as shareholder, which are attached to the shares forming part of the estate;

- Performs legal acts towards the employees of the debtor as their employer; and
- Procures the operation of the debtor's business (enterprise), keeping of accounting books and discharge of tax obligations.

The declaration of bankruptcy also brings consequences to the creditors. Generally, upon a declaration of bankruptcy, the creditors of the debtor may exercise their rights only under the terms and conditions and in the manner stipulated by the Insolvency Code. Additionally, all of the creditors' claims against the debtor which are not yet due become due and payable, except in some special cases set forth by the Insolvency Code.

Reorganisation

Another mechanism for dealing with insolvency is reorganisation. Reorganisation is available to debtors who are physical persons as well as entities, provided that the total turnover of such debtor reaches at least CZK 50,000,000 (approximately EUR 1,825,000 or USD 2,500,000) or such debtor employs at least 50 employees. A reorganisation is not possible if the entity is in liquidation.

The motion for allowing the reorganisation may be filed by the debtor or by any of the creditors who registered their claims in the insolvency proceedings. However, such person must believe in good faith that the conditions stipulated for an approval of a reorganisation plan are or will be fulfilled. The debtor is only allowed to propose reorganisation before the court rules on its insolvency. Thereafter, the right to propose reorganisation remains only with the creditors having registered claims, who may file such a motion no later than 10 days before the first creditors' meeting after the Insolvency Court decides on the insolvency of the debtor.

The Insolvency Court approves the reorganisation, unless: it is justified to presume that, with regard to all circumstances, the motion pursues an unfair intention; the motion was filed by a person on whose motion for approval of reorganisation has already been decided by the Insolvency Court; or the motion was filed by a creditor and the creditors' meeting did not approve such motion. If the motion was filed by the debtor, there is no need for approval by the creditors' meeting.

If the Insolvency Court approves the motion on reorganisation, the debtor has a priority right to produce a key document of the reorganisation: the reorganisation plan.

The Reorganisation Plan

The reorganisation plan stipulates the legal standing (rights and obligations) of the concerned persons as a result of the approved reorganisation. This legal standing is set by the measures stipulated in the reorganisation plan, which aim at revitalisation of the debtor's business, and through the regulation of mutual relationships between the debtor and its creditors. The upcoming proceedings of the reorganisation must be conducted in harmony with the approved reorganisation plan, unless the reorganisation plan is amended accordingly.

The Insolvency Court must approve the reorganisation plan if: the plan is prepared in accordance with the Insolvency Code and other laws; it is justified to presume, with regard to all circumstances, that no unfair intention is pursued by the plan; the plan was approved (or is deemed approved) by each class of the creditors; each creditor receives performance of at least the same value as it would receive if the insolvency was dealt by bankruptcy, unless the receiving creditor agrees to a performance of lower value; and all claims against the estate are to be paid upon the reorganisation plan becoming effective.

Reorganisation can be performed (by way of example) by the following actions: restructuring of creditors' receivables; sale of the entire estate or a part thereof; sale of the debtor's enterprise; surrender of a part of the debtor's assets to a creditor or to a newly established legal entity in which a creditor holds equity shares; merger of the debtor (in case the debtor is a legal entity) with another legal entity or transfer of its equity to a debtor's shareholder or participant; issue of shares; change in debtor's statutes; or raising of financing of the debtor's enterprise or a part thereof.

The Insolvency Court may decide upon changing the reorganisation procedure into a bankruptcy, unless the reorganisation plan has already been fulfilled in its substantial elements. The Insolvency

Court will issue a decision acknowledging the fulfilment of the reorganisation plan. By this decision, the reorganisation comes to an end.

Debt Clearance

Debt clearance (discharge of debts) is a manner of resolving the insolvency of natural persons or non-entrepreneurial legal entities. It does not guarantee a complete financial indemnification to the creditors. It is often used as a solution for so-called consumer insolvency, where the debtor's debts are drawn together, secured creditors are satisfied to the full extent, the unsecured creditors are satisfied to some agreed extent, and the rest of the debts are discharged, meaning that such debts remain only as unenforceable obligations.

The proposal for permission for debt clearance may be filed exclusively by the debtor itself along with the insolvency petition. In the event that a creditor rather than the debtor files the insolvency petition, the debtor may, within 30 days after the insolvency petition is delivered to the debtor, file a proposal for permission for debt clearance.

For permission for debt clearance, it is primarily necessary to define how debt clearance will be carried out. The Insolvency Code offers two alternative methods for debt clearance: either a sale of assets or the setting and fulfilment of a payment calendar.

A decision about the manner of debt clearance rests upon the unsecured creditors. The decision is taken into consideration by the Insolvency Court when it considers the proposal. If the Insolvency Court rejects the proposal, insolvency is automatically resolved through bankruptcy.

In cases of a converting sale of the debtor's assets, the insolvency administrator performs the sale and proceeds to act in a way similar to that of bankruptcy. The sale does not touch the rights of secured creditors.

In cases of setting a payment calendar, the debtor is, for a period of five years, obliged to pay to the unsecured creditors monthly instalments amounting to a specified part of the debtor's income. The debtor, through the insolvency administrator, distributes this amount among the unsecured creditors pro rata in a manner determined by the Insolvency Court. Secured creditors are satisfied only from the proceeds of the security. By repayment according to the payment calendar, at least 30% of claims of unsecured creditors must be satisfied, unless the unsecured creditors agree otherwise. If the debtor is in default with respect to its obligations under the payment calendar for longer than 30 days, bankruptcy will be automatically declared.

The debtor is supervised by the insolvency administrator, the Insolvency Court and the creditors' committee. The debtor has to submit a summary of its income in the previous period to all relevant creditors every six months.

The Insolvency Court terminates debt clearance proceedings after five years from the decision on permission of debt clearance when the debtor fulfils all obligations set forth by the Insolvency Court duly and in time. The debtor is then entitled to file a proposal for discharge of payment of all claims which were not satisfied so far. Such claims survive as unenforceable obligations.

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