

## Covid-19 coronavirus

### Business as usual for derivatives and similar financial transactions with Czech counterparties?

The Czech Parliament is debating a set of new draft bills that are likely to affect a myriad of financing transactions on the Czech market. The bills are expected to enter into force fairly quickly in the course of April 2020. We have prepared a summary of the most relevant upcoming changes relating to derivatives and similar financial transactions entered into with Czech counterparties under the Czech Banking Association Master Agreement for Financial Transactions (the **Czech Master Agreement**), the 2002 ISDA Master Agreement (the **ISDA Master Agreement**), the Global Master Repurchase Agreement (2011 version) (**GMRA**) and the Global Master Securities Lending Agreement (January 2010 version) (**GMSLA**) (together the **Master Agreements** and each individually a **Master Agreement**).<sup>1</sup>

#### Extraordinary Moratorium and Related Amendments to Czech Insolvency Laws

The Czech Parliament is debating a draft bill containing temporary changes to the Czech insolvency regime aiming to mitigate the impact

of various measures adopted in response to the Covid-19 pandemic.

In this context, the draft bill provides that any insolvency petitions filed by creditors of a Czech debtor until 31 August 2020 should be disregarded. Any such filings made until the end of August would have to be made again in September 2020 in order to effectively commence insolvency proceedings. This restriction applies to all creditors, including foreign creditors, of a Czech debtor (i.e., a debtor with its COMI in the Czech Republic).

#### Extraordinary Moratorium

The draft bill creates a brand new and bespoke regime for Czech debtors. Until 31 August 2020, a Czech debtor which was not insolvent as of 12 March 2020 can apply for an extraordinary moratorium for an initial period of three months. To that end, the Czech debtor will have to file a simple application form with, *inter alia*, an attached affidavit representing that:

- a) the Czech debtor files the application due to impacts of the Covid-19 Extraordinary Measures\*;
- b) the Czech debtor was not insolvent as of 12 March 2020; and

<sup>1</sup> Capitalised terms not defined in this note have the meaning ascribed to them in the relevant Master Agreement.

- c) the Czech debtor had not paid out any extraordinary funds to its shareholders, members of its bodies or its group members, unless such extraordinary payments were returned.

\*The draft bill defines the **Covid-19 Extraordinary Measures** rather broadly. It covers any measure declared by the Czech government or a measure declared by the Czech Ministry of Health or by a Czech Regional Public Health Station in the Czech Republic relating to public health protection and Covid-19 spread limitation.

It will be possible to extend the extraordinary moratorium by an additional three months, subject to prior consent of the majority of creditors based on the amount of their due receivables.

The main effects of the extraordinary moratorium would be that:

- limitation periods that would otherwise affect creditors' rights and their enforcement against the Czech debtor are fully and automatically suspended;
- the Czech debtor could be sued but judgments could not be enforced against it;
- significant asset disposals would generally be prohibited, except in the usual course of business;
- the Czech debtor could prioritize payment of debts incurred while the extraordinary moratorium is in place (these debts would have priority ranking in any subsequent insolvency proceedings); and
- the Czech debtor's counterparties would not be entitled to terminate or refuse to perform certain essential pre-existing contracts for as long as the debtor continues to meet at least its obligations arising during the moratorium.

However, the extraordinary moratorium generally does not affect ordinary set-off.

Since the extraordinary moratorium is not notified as an eligible proceeding under Regulation (EU)

2015/848 of the European Parliament and of the Council dated 20 May 2015 on insolvency proceedings (recast) (the Insolvency Regulation), its protective effect does not extend to proceedings carried out outside of the Czech Republic. This also means that various specific rights relating to ordinary set-off or security enforcement which are otherwise granted and available under the Insolvency Regulation will not be available.

### Certain Other Changes Contained in the Draft Bill

The draft bill would suspend obligations of Czech debtors (and their directors) to file for insolvency when normally required by law. This suspension should last until the end of a six-month period starting from cancellation of the Covid-19 Extraordinary Measures, but not extending beyond the end of 2020.

The draft bill would also automatically suspend all suspect periods in connection with transfers at undervalue, preferences and fraudulent transfers for the period of applicability of the Covid-19 Extraordinary Measures (i.e., for the same period as the obligation to file for insolvency would be suspended).

### Impacts on Transactions under the Master Agreements

None of the changes introduced by the draft bill should affect the ability of a counterparty under derivative or similar financial transactions entered into under a Master Agreement to perform close-out netting in respect of such transactions under an eligible close-out netting arrangement. Nor will the changes proposed in the draft bill affect validity or enforceability of financial collateral arrangements, if these are made in line with the relevant documentation and in accordance with other applicable Czech laws.

### Applicability of Bankruptcy or Insolvency Event of Default

The commencement of an extraordinary moratorium does not evidence the Czech debtor's inability to pay its debts but serves

primarily as a protective measure. Accordingly, a counterparty to derivative and other financial transactions entered into under a Master Agreement with a Czech counterparty should consider whether the filing for and commencement of the extraordinary moratorium (the **Commencement of the Extraordinary Moratorium**) triggers the relevant bankruptcy or insolvency Event of Default under that Master Agreement.<sup>2</sup> While we express some initial views with respect to interpretation of certain provisions of the Master Agreements below, any final assessment as to the applicability of the relevant bankruptcy or insolvency Event of Default in the event of the Commencement of the Extraordinary Moratorium will have to be made on a case-by-case basis taking into account all circumstances of the specific contractual relationship. In particular, such assessment will need to reflect upon all communication the parties made in the course of negotiation of the relevant Master Agreement, regular use of certain terms in a transactional practice between the parties and customs applicable in the relevant industry.

### Czech Master Agreement

The Commencement of the Extraordinary Moratorium does not seem to fall within the scope of the definition of an *"Insolvency Proceeding"* as defined under the Czech Master Agreement as the definition only covers, *inter alia*, a *"voluntary proceeding seeking a judgment, order or arrangement of insolvency, bankruptcy, composition, amicable settlement, rehabilitation, reorganisation, administration, dissolution or liquidation with respect to a party or its assets"*, but does not include moratoria or other residual categories, such as any other reliefs applicable under insolvency, bankruptcy or similar laws. This conclusion applies to all editions of the Czech Master Agreement.

### ISDA Master Agreement

Under the ISDA Master Agreement, the *"Bankruptcy"* Event of Default covers a situation

where a party *"institutes or has instituted against it [...] a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law [...] affecting creditors' rights [...] and [...] is not dismissed, discharged, stayed or restrained in each case within 15 days of the institution or presentation thereof"*. Since the residual category of *"any other relief"* is very broad and because the extraordinary moratorium should be included directly in the Czech Act on Insolvency<sup>3</sup>, we believe that the Commencement of the Extraordinary Moratorium ought to fall within the scope of the *"Bankruptcy"* Event of Default as defined under the ISDA Master Agreement.

### GMRA and GMSLA

The definition of an *"Act of Insolvency"* under the GMRA or GMSLA requires there to be, *inter alia*, *"the presentation or filing of a petition in respect of [the party] [...] in any court [...] alleging or for the bankruptcy, winding-up, insolvency of such party [...] or seeking any reorganisation, arrangement, composition, re-adjustment, administration, liquidation, dissolution or similar relief under any present or future statute, law or regulation, such petition not having been stayed or dismissed within 15 days of its filing"*. Therefore, for the Commencement of the Extraordinary Moratorium to qualify as an *"Act of Insolvency"*, it would have to constitute a relief measure "similar" to the relief measures listed in this paragraph.

However, the aim and consequences of the Commencement of the Extraordinary Moratorium seem to be different from the measures referred to in the definition of an *"Act of Insolvency"*. The Commencement of the Extraordinary Moratorium would therefore most likely not fall within the residual category of "similar relief".

### Applicability of Failure to Pay or Deliver Event of Default

<sup>2</sup> Section 6(1)(viii) of the Czech Master Agreement, Section 5(a)(vii) of the ISDA Master Agreement, Paragraph 10(a)(vi) of GMRA and Paragraph 10.1(d) of GMSLA.

<sup>3</sup> No. 182/2006 Coll., as amended.

If the Czech debtor fails to pay or deliver under a transaction contrary to a Master Agreement, then, regardless of certain effects of the extraordinary moratorium preventing the Czech debtor's suppliers to terminate or refuse to perform certain contracts, its counterparty under the Master Agreement will be able to trigger the failure to pay or deliver Event of Default, however phrased in the relevant Master Agreement.<sup>4</sup>

Neither the Czech insolvency laws nor the effects of the extraordinary moratorium affect the right to trigger the failure to pay or deliver Event of Default as eligible close-out netting arrangements (including the contractual trigger events) remain protected under Czech insolvency laws.

### Suspension of Payments under Credit Facilities and Loans and Similar Financing Agreements

The Czech Parliament is also debating a draft bill which would ultimately result in suspension of certain payment obligations under, and some temporary changes to, credit facilities, loans and similar financing agreements agreed and utilised and, in some cases, agreed but not utilised, before 26 March 2020, if the Czech borrower opts in such protection.

This draft bill grants rights to Czech borrowers, including corporations, to ask their lenders for suspension of payments under credit facilities, loans and similar financing agreements until 31 October 2020 (if so selected by the borrower). As far as Czech corporations are concerned, this protective period will not affect their duty to make interest payments; however, such Czech borrowers may stop paying amortized payments of the principal.

The draft bill expressly excludes from its scope, inter alia, (i) financial instruments within the meaning of Annex I Section C of MiFID 2;

(ii) obligations the subject matter of which is such a financial instrument; (iii) obligations giving rise to receivables of financial nature secured by a financial collateral arrangement<sup>5</sup>; or (iv) margin loans. Therefore, it should not directly adversely affect rights of counterparties of such in-scope Czech counterparties to require payments under derivatives or similar financial transactions entered into under Master Agreements.

Unfortunately, the draft bill is likely to cause an asymmetry between payments and deliveries under any currency hedging transactions and repayments of the loan if the Czech borrower requests an extension of the term of the loan, effectively changing the agreed term sheet.

<sup>4</sup> Section 6(1)(a)(i) of the Czech Master Agreement, Section 5(a)(i) of the ISDA Master Agreement, Paragraphs 10(a)(i)-(v) of GMRA and Paragraphs 10.1(a)-(c) of GMSLA  
<sup>5</sup> For a detailed discussion of the scope of receivables of financial nature and financial collateral arrangements, please see p. 18 *et seq.* of the Industry Netting Opinion (*Enforceability under Czech Law of Close-out Netting of Privately Negotiated*

*Derivatives Transactions under the 1992 ISDA Master Agreements and the 2002 ISDA Master Agreements*) dated 2 August 2019 and p. 28 *et seq.* of the Legal Opinion in respect of validity and enforceability under Czech law of the Czech Master Agreement dated 12 March 2020.

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term partner is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2020. This document is for general guidance only and does not constitute definitive advice.