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Restructuring across borders

Czech Republic

Corporate restructuring and
insolvency procedures | January 2022



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Introduction

The Czech Republic's 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 all types of proceedings.

This reform aimed to introduce a “rescue culture” into the Czech Republic, making available a reorganisation proceeding as a non-liquidation form of insolvency procedure. Since 2008, the Insolvency Act has been substantially amended. Still, it does not envisage a light-touch restructuring process akin to a scheme of arrangement. Changes are expected in connection with the implementation of the EU Directive (EU) 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications (the **Directive on Restructuring and Insolvency**), for instance a new bill on preventive restructuring is being prepared by the government and discussed with the stakeholders (for more details see p.9 below).

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 by the debtor or by any creditor with a due receivable to the materially competent insolvency court. There is also a special regime for certain subjects with business on capital markets being insolvent (see the next page). However, only the publication of the information about the commencement of the proceedings in the publicly-available insolvency register triggers the main effects vis-à-vis the debtor and third parties; the mere delivery of the insolvency petition is not enough. In the first stage of the proceedings, the court will examine whether the debtor is insolvent or under threat of 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 be generally bound by the decision



Introduction (cont.)

of creditors taken at a creditors' meeting except for discharge of debts where the creditors might vote only about the method thereof. As a general rule, the court must issue the decision on the resolution of the debtor's insolvency within three months of 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 a discharge from debts.

Either the debtor itself or its creditors (and the relevant supervisory authority – the Czech National Bank – 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 liable persons according to Paragraphs b) and c) of 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 insolvency¹.

Unless one of few strict exceptions concerning the grounds of the insolvency petition applies (see below), the court must generally 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. 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 under strict rules. Consequently, it may either reject 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 of receipt of the insolvency petition.

Creditors may file their claims from the date of the initiation of insolvency proceedings. The insolvency court must place in the insolvency register (i) a notice for creditors to file their claims and (ii) a decision declaring the debtor insolvent. This declaring decision is also the end of the above-mentioned first stage and the creditors have to file their claims within a two-month period following the date of this declaring decision. Claims filed after the lapse of the period will be disregarded. Different rules apply for: (i) certain preferential creditors (including the debtor's employees) who do not file their claims but exercise their claims directly against the insolvency administrator (*insolvenční správce*) or the debtor; creditors of (ii) banks, savings and credit co-operatives following the revocation of their respective licences; (iii) securities traders that are investment firms under Article 4, Paragraph 1 Point 2 of the Regulation of the European Parliament and of the Council (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms; and (iv) liable persons according to Section 3, Paragraphs b) and c) of 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. Those claims are considered filed in the amount set out in the debtor's books.

Also, the so-called known EU creditors have a special deadline (not less than 30 days) for applying their claims that is triggered by obtaining a notice about the deadline for the lodgement of their claims.

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/her place. 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 a 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

1. In this context, insolvency could be present in two basic forms. The first form is a financial insolvency (ie when the debtor figures out that it has (i) several creditors, (ii) financial liabilities for more than 30 days overdue and (iii) it is not able to fulfil such liabilities). The second form is a state of excess debts (ie usually, when the debtor figures out that the total of their liabilities exceeds the value of their property). The state of excess debts is relevant only for a debtor who is a legal entity or a natural person (ie an entrepreneur (eg a sole proprietor)) and it is more complicated to figure out than a financial insolvency, as eg aspects of liquidity and going-concern value of debtor's property have to be taken into consideration.

Introduction (cont.)

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 its 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. Under certain conditions, the voting rights of Registered Creditors may be restricted (eg if the creditor forms a group with the debtor).

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. Unsecured creditors have the

right to appoint at least an equal number of creditors' committee members as secured creditors. The members of the creditors' committee may be natural persons as well as corporate entities. 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 shall regularly approve 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 or to the avoidance of a damage that could be otherwise caused to the insolvent estate. 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*). A preliminary administrator is in general likely to be appointed (before declaring the debtor insolvent) in circumstances where the insolvent estate is large and complex or if the insolvency court approved a moratorium.

As part of its decision declaring the debtor insolvent, the insolvency court will appoint an insolvency administrator.

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)

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 potential subsequent legal acts of the debtor are automatically 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 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 and creditors. The performance of the reorganisation plan is continuously monitored by creditors.

Reorganisation is available only to debtors involved in a business activity, ie who are entrepreneurs² and, as a general rule, only to those exceeding a certain size in terms of turnover generated in the last accounting period (CZK50,000,000 (approximately EUR2,000,000) or more) or the number of its 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 and liable persons according to the Section 3, Paragraphs b) and c) of 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 not 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 (in case of debtor's insolvency) may apply for reorganisation, provided, however, that the applicant applies in good faith and all

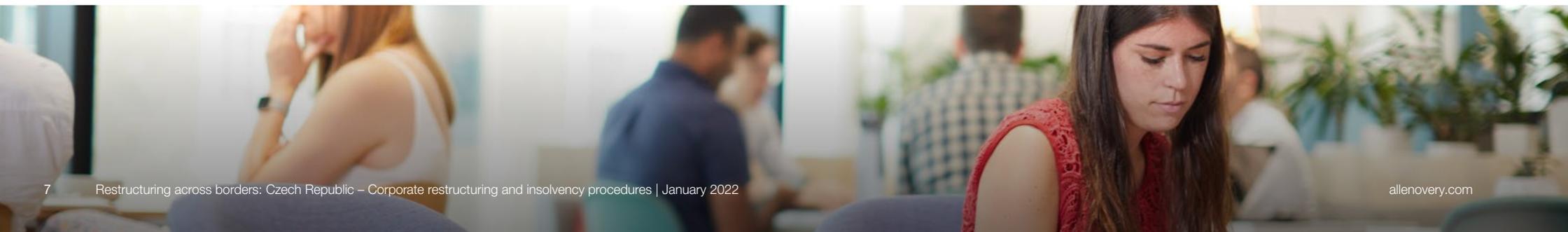
the requirements for the approval of the reorganisation plan are, or will be, met. Strict time limits apply for the filing for reorganisation. If the insolvency petition was filed by the debtor on the basis of a threatened insolvency, the debtor must apply for reorganisation before the insolvency court issues a decision declaring the debtor insolvent.

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 whilst this period can be extended up to another 120 days). The plan may be submitted also 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 the reorganisation.

2. An entity (a legal or natural person) is considered to be an entrepreneur, with regard to this activity, if it carries out a gainful activity on its own account and responsibility, independently with the intention to do so consistently for profit and in the form of a trade or in a similar manner.



Reorganisation (reorganizace) (cont.)

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 an individual class of its own. 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 of the creditors and by their votes in the amount of 50% in value of claims of the creditors that took part in the voting in that class (both of the conditions will need to be met). 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 (cross-class cram down).

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) to the extent stipulated by the reorganisation plan and only persons included in the reorganisation plan will be deemed as 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 natural person regardless of whether he or she is an entrepreneur. In theory, a corporate entity is under specific circumstances also eligible for a discharge of debts. In practice, the discharge from debts process is used predominantly by natural persons, rather than any form of corporate entity.

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.

Two types of the discharge of debts exist: (i) liquidation of the debtor's estate akin to the sale of all relevant assets of the debtor as in bankruptcy; or (ii) repayment schedule with the sale of debtor's assets (some classes of assets might be protected). Unless creditors vote specifically for a discharge of debts in the manner of the liquidation of the debtor's estate, the repayment plan with the sale of debtor's assets takes place.

The repayment plan generally lasts for five years unless some exceptions apply. Further changes are expected in connection with the implementation of the Directive on Restructuring and Insolvency in the course of 2022 (mainly shortening of the repayment plan to three years).

Preventive restructuring

As of now, Czech law does not provide for a complex framework regarding out-of-insolvency restructuring (preventive restructuring) akin to a scheme of arrangement under English law. Therefore, any restructuring of financial indebtedness is subject to the consent of all the stakeholders involved.

Draft law on preventive restructuring implementing the Directive on Restructuring and Insolvency is expected to enter formal legislative process in the upcoming weeks. It will bring about new tools for entrepreneurs to restructure their debts presumably in these light touch proceedings with limited court involvement.



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 (*oddlužení*) 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 (*oddlužení*) are listed in Annex A.



Key contacts

If you require advice on any of the matters raised in this document, please contact any of our partners or your usual contact at Allen & Overy, or email rab@allenoverly.com

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Further information

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, Asia, the Middle East and the U.S.

To access this resource, please [click here](#).



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