A&O SHEARMAN

Restructuring across borders
Czech Republic

CORPORATE RESTRUCTURING AND INSOLVENCY PROCEDURES | JANUARY 2024

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Introduction

The Czech Republic's 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 insolvency 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. Under the Insolvency Act, the concept of a single gateway procedure for insolvent debtors applies in the Czech Republic.

In 2023, Act No. 284/2023 Coll., on preventive restructuring (the **Preventive Restructuring Act**) implementing EU Directive (EU) 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications (the **Directive on Restructuring and Insolvency**) has come into effect and introduced a completely new legal way of dealing with a company's financial difficulties as it transitions between solvency and insolvency, but would likely become insolvent if no restructuring measures were taken.

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

- preventive restructuring (*preventivní restrukturalizace*);
- bankruptcy (*konkurs*);
- reorganisation (*reorganizace*); and
- discharge from debts (*oddlužení*).

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 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 of the creditors taken at the 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.

Introduction (cont.)

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 Section 3, 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 insolvency.[1]

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 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 cooperatives 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 are 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 voting rights of this creditor. On the other hand, if the validity of a creditor's claim is disputed by the insolvency 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).

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 balance-sheet insolvency (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.)

Where there are more than 50 Registered Creditors, the Registered Creditors (through a decision made in a creditors' meeting) must elect a creditors' committee (*veřitelský 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

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 entrepreneurs[2] 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 Section 3, Paragraphs b) and c) of Act No. 374/2015 Coll., on recovery measures and crisis solutions, 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.

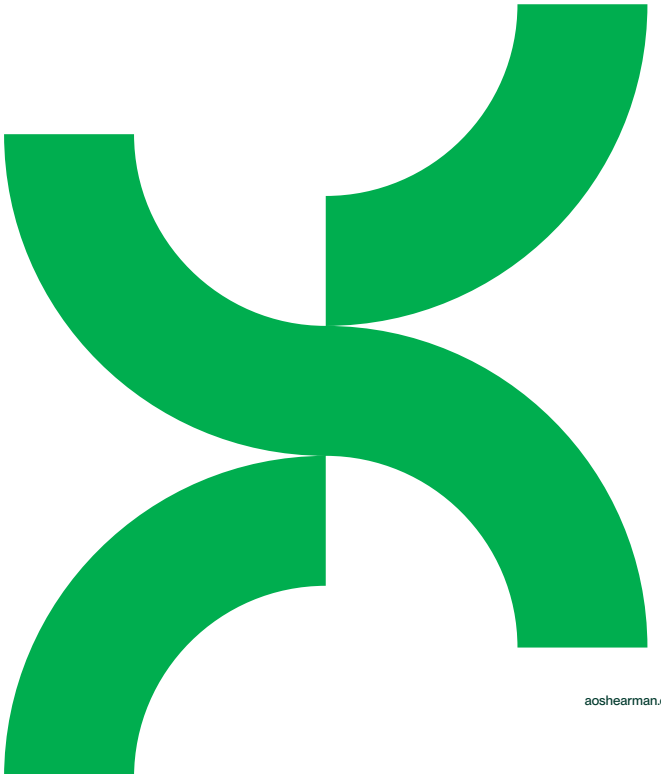
Reorganisation (reorganizace) (cont.)

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.

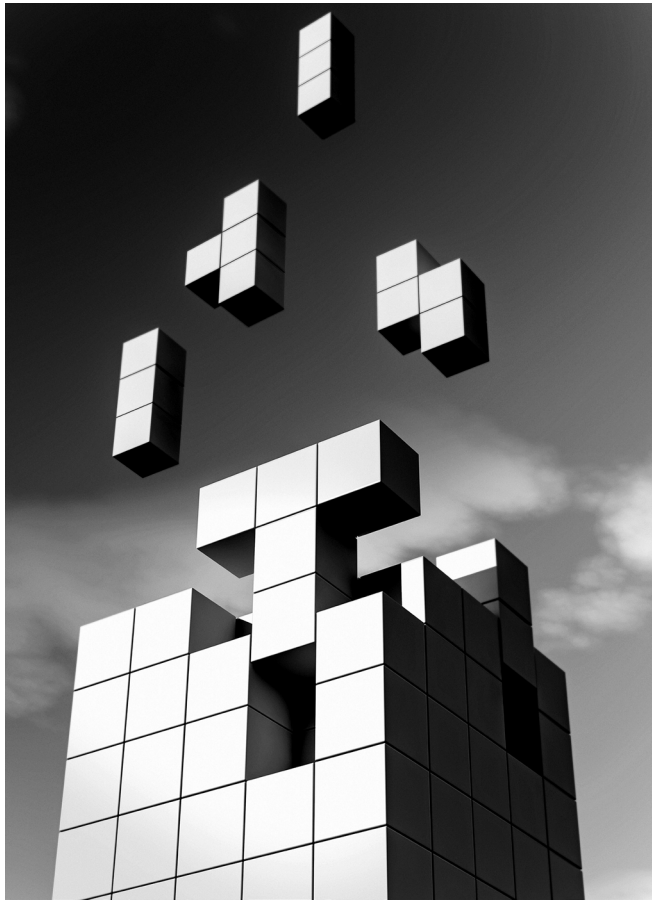
Preventive restructuring (preventivní restrukturalizace)

The Act on Preventive Restructuring transposes the Directive on Restructuring and Insolvency, which aims to harmonize the preventive restructuring process across the EU. The Act on Preventive Restructuring introduces into Czech law a completely new legal way how to withstand financial difficulties of a debtor in a timely manner so that it can keep existing, carry on its business and avoid insolvency proceedings. Compared to insolvency proceedings, it is less public and formal and, at the same time, more voluntary and consensual. Thus, it put in place a process akin to US Chapter 11 or UK Scheme of Arrangement.

Under the Act on Preventive Restructuring, preventive restructuring can be initiated only by a business corporation that is not in financial insolvency, but the financial difficulties of the debtor would likely result in insolvency if no restructuring measures were taken. Moreover, the debtor can initiate and continue in preventive restructuring only if it believes in good faith that the restructuring plan, aimed at maintaining or restoring its operations, can be fulfilled. This condition should prevent initiation of obviously futile preventive restructuring.

To withstand the financial difficulties and the likelihood of insolvency, the debtor can use certain restructuring measures, which must be described in the restructuring plan in detail. These include, among others, changing the composition of the debtor's assets by selling a part of the debtor's assets, changing the structure of the debtor's liabilities, changing the structure of the debtor's capital, any other necessary operational changes, or a combination of the above measures. This list is non-exhaustive and serves as guidance for the debtor.

One of the main and most useful instruments in preventive restructuring is the general and individual moratorium. It can be declared for a maximum of three months and can be extended for another three months. During the period of a moratorium, a stay of individual enforcement action applies, effectively suspending every enforceable action granted by a judicial or administrative authority or by other means. That gives the debtor enough time to negotiate with its creditors and to prepare a restructuring plan.



Preventive restructuring (preventivní restrukturalizace) (cont.)

During a moratorium, unfulfilled contracts for the supply of goods, services, energy or other types of performance that are necessary for the continuation of the normal operation of the debtor cannot be terminated by the other party for the sole reason that the debtor has due debts.

The restructuring plan must be put to a vote of the affected parties divided in classes. The classes are formed by the debtor in the restructuring plan in a way that ensures that each class has affected parties with the same legal standing and economic goals. Affected parties in the same class must be treated equally by the restructuring plan. The restructuring plan is accepted if at least 75% of the affected parties in each class voted for it.

However, the court will reject the restructuring plan approved by the affected parties in certain scenarios, such as if the restructuring plan is contrary to the law, the restructuring plan was approved by the affected parties in breach of the law, or the restructuring plan is unlikely to prevent the company from insolvency.

On the other hand, the court will sanction the restructuring plan not approved by the affected parties (cram-down) in certain scenarios. For example, if there is no legal ground for the rejection of the restructuring plan, the restructuring plan was approved by the majority of classes which did not include related parties (i.e. person in the debtor's governing body or shareholder exercising control over the debtor) and at least one of the classes which voted for the restructuring plan would be satisfied before unsecured creditors with unsubordinated claims in the insolvency proceedings.

If the preventive restructuring ends unsuccessfully and the debtor becomes insolvent despite the implemented restructuring measures, those affected parties which provided interim or new financing to the debtor during the preventive restructuring will have priority claims related to the interim or new financing in the insolvency proceedings with the debtor.

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 A&O Shearman, or email **rab@aoshearman.com**.

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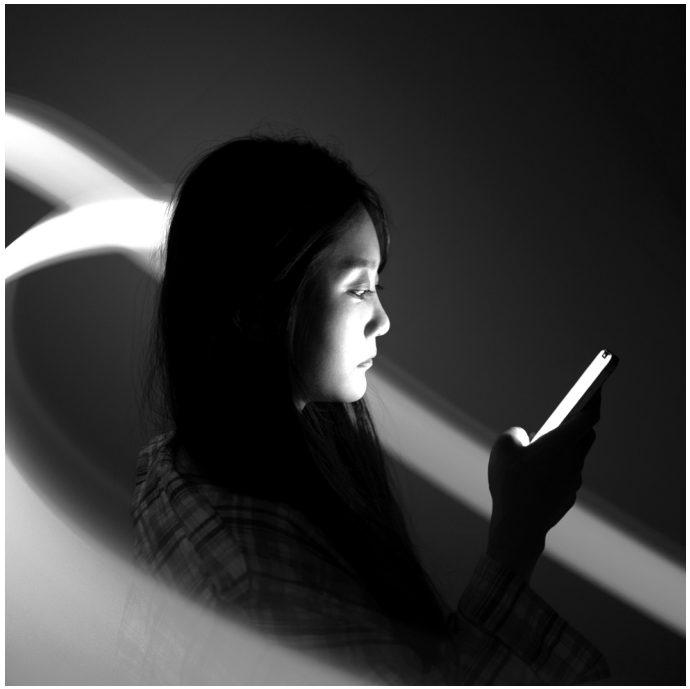
Further information

Developed by A&O Shearman'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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