Global Restructuring and Insolvency Guide - Czech Republic

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**Remark:** The Czech Republic is a member of the European Union. Please refer to the section "European Union" under Quick Links below to learn more about the implications with respect to the European rules that apply in the field of restructuring and insolvency. The EU Restructuring Directive is still to be implemented in Czech Republic.

# Initial Considerations

## Can you take security over all types of assets, including accounts receivable?

**Insolvency proceedings**

Czech law allows security to be taken over any property that can be traded. This includes physical objects as well as rights, claims or receivables. However, certain requirements need to be met for a security interest to be created effectively, and the requirements may vary depending on the kind of property. As a general requirement, the assets to be taken as security need to be specified in order to be identifiable. Accounts receivables can form security as long as these can be sufficiently specified and as long as they are assignable.

## What is the nature of the insolvency process?

**Insolvency proceedings**

Insolvency proceedings aim to limit losses that may be suffered by creditors in the event of insolvency. Insolvency proceedings in the Czech Republic are always judicial proceedings led 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. Afterward, 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. An 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.

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 (konkurs), where the debtor's assets are sold and after priority claims, including the costs of the proceedings, have been paid, the creditors' claims are proportionally satisfied using the proceeds of the sale. Unsatisfied claims do not cease to exist unless prescribed otherwise in the Insolvency Act. Bankruptcy always leads to a liquidation of a debtor that is a legal entity.

Reorganization (reorganizace), where the debtor's business is preserved and operated pursuant to an approved reorganization plan under the creditors' supervision. The creditors' receivables are paid off gradually. Reorganization is available only for entrepreneurs.

Debt clearance (oddlužení), where all due obligations of the debtor are extinguished subject to the conditions stipulated by the Insolvency Court conducting the proceedings. Debt clearance is available only for debtors who are not entrepreneurs, especially natural persons; therefore, the specifics of debt clearance will not be taken into account below.

Please note that the information provided below focuses on entrepreneurs.

## What is the solvency requirement for a company to file a case in this jurisdiction?

**Insolvency proceedings**

A company as a debtor is insolvent and is obligated to file for insolvency if it is either illiquid or over-indebted.

A debtor is illiquid if it is unable to pay its debts as they fall due and:

Has more than one creditor

Has due and payable monetary obligations that have been overdue for more than 30 calendar days

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 is over-indebted if:

It has more than one creditor.

The sum of its obligations exceeds the value of its assets. When determining the value of the debtor's assets, 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").

The Czech law further defines impeding insolvency as a state when 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. If the company is in the state of impending insolvency, it may also file for insolvency, but it is not obligated to do so.

## Is there a requirement to demonstrate COMI ("centre of main interests") for a company to file a case in this country?

**Insolvency proceedings**

Yes. The Czech Republic is a member state of the European Union, and, accordingly, the EU Insolvency Regulation applies. This means that Czech courts only have jurisdiction in insolvency proceedings of debtors whose COMI is located in the Czech Republic.

## Is restructuring of both secured and unsecured claims possible?

**Insolvency proceedings**

Yes, both secured and unsecured claims may be affected by a restructuring (reorganization) plan (e.g. ., partially written down or postponed as a result of a reorganization plan, capitalized by debt-to-equity swap or otherwise restructured). Generally, the reorganization plan has to be approved by the creditors. For this purpose, the creditors are divided into groups and, as a general rule, each secured creditor forms a separate group. However, under certain conditions, the Insolvency Court may approve the reorganization plan even if it was not approved by each group of creditors.

## Are the claims of creditors and shareholders put into separate classes for purposes of voting and treatment under the plan or scheme?

**Insolvency proceedings**

Yes. First, there is a differentiation between secured and unsecured creditors of the debtor. Second, the law gives priority to some types of claims (please see below in the section "What is the order of priority of claims?").

A secured creditor is a creditor whose claim is secured by assets belonging to the estate in the form of a lien, right of retention, conveyancing restriction, fiduciary transfer of a right, assignment of a claim to the collateral, or similar right under foreign law. Secured creditors' claims are satisfied from the full amount of the proceeds from monetization, less the insolvency administrator's fee and the costs of management and monetization, at any time during the proceedings, taking account of the time of inception of the security. However, the security may be challenged under certain circumstances.

All other creditors are unsecured. Their status in the insolvency proceedings is weaker and the projected level at which their claims will be satisfied, according to statistical data, is usually much lower.

With some exceptions, registered creditors may vote at the creditors' meeting in relation to voting. The exceptions from voting usually encompass creditors with claims against the estate and equivalent claims, creditors with subordinate claims, creditors with rejected claims and creditors with conflict of interest. On some issues, such as the removal of the insolvency trustee, all creditors vote in one class. However, for voting on other issues such as the election of the creditors' committee or reorganization plan, the voting takes place separately in classes (classes of secured and unsecured creditors, or classes according to the priority of the claim). Shareholders are in the position of creditors only if they have a receivable from the debtor. In certain cases, they are prevented from being members of the creditors bodies and cannot exercise voting rights at the meetings of such bodies unless the Insolvency Court decides otherwise.

## Is shareholder approval needed to commence a case? Are shareholders entitled to vote on a plan?

**Insolvency proceedings**

No, the commencement of insolvency proceedings does not require shareholders' approval if filing an insolvency petition is mandatory. Under the Business Corporations Act, in case of impending insolvency, the board (executives) has an obligation to convene the general (shareholders') meeting without undue delay and shall propose that the general meeting takes appropriate action (e.g., restructuring, dismissing employees, selling a plant, receiving shareholder's surcharge outside the registered capital, dissolving the company). Therefore, if filing is voluntary (i.e., in case of impending insolvency), shareholders' consent may be required.

Generally, the claims of shareholders as creditors (e.g., shareholder loans) are treated equally to the claims of all other creditors, subject to and in accordance with the statutory classification of creditors. However, in certain situations, some limitations may apply. For example, the shareholders' creditors in the same group as the debtor cannot vote or their voting rights may be restricted. Some limitations may also apply if the debtor-company is a so-called close person to the shareholder.

## Is there an ability to bind minority dissenting creditors (i.e., cramdown)?

**Insolvency proceedings**

Minority creditors may be bound by decisions taken by the relevant majority of creditors or by the Insolvency Court. Sometimes the creditors are divided into groups (like, for instance, in reorganizations) and the calculation of a majority may be governed by different rules.

# Commencing the Process

## Who can commence?

**Insolvency proceedings**

The insolvency proceedings are commenced on the basis of an insolvency petition. In general, 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 is voluntary and can only be filed by the debtor.

If the debtor is a legal entity or an entrepreneur, 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. This obligation also applies to the members of its statutory body and other potential debtor representatives.

## Is shareholder's consent required to commence proceeding?

**Insolvency proceedings**

No, the commencement of insolvency proceedings does not require shareholders' approval if filling an insolvency petition is mandatory.

Under the Business Corporations Act, in case of impending insolvency, the board (executives) has an obligation to convene the general (shareholders') meeting without undue delay and shall propose that appropriate actions take place at the general meeting  (e.g., restructuring, dismissing employees, selling a plant, receiving shareholder's surcharge outside the registered capital, dissolving the company). As a result, if filing is voluntary, shareholders' consent may be required.

## Is there an ability to consolidate group estates?

**Insolvency proceedings**

No, insolvency proceedings for each legal entity are formally independent of one another. However, in the event that related entities are subject to insolvency proceedings, the administrators may cooperate to a certain degree. However, each administrator must act in the best interest of the creditors of his or her estate. Further, it is possible to consolidate insolvency proceedings over group companies at the same insolvency court.

## Is there any court involvement?

**Insolvency proceedings**

Yes, the competent Insolvency Court makes decisions and oversees the entire procedure. In particular, the Insolvency Court decides whether the debtor is insolvent, decides on how to resolve the insolvency, appoints the insolvency administrator and approves certain other actions.

## Who manages the debtor?

**Insolvency proceedings**

Subject to significant restrictions, the debtor continues to hold the right to manage estate assets until the decision on insolvency and has the management right thereafter until the decision on how to resolve the insolvency is made. Depending on the procedure, both decisions may be issued at once (decision on insolvency may include the decision on how to resolve it) or after one another with a certain time period in between. In certain cases, the Insolvency Court could appoint an interim insolvency administrator even prior the insolvency decision.

In bankruptcy proceedings, the court-appointed insolvency administrator manages estate assets and has the authority to dispose of the estate, to exercise rights and to discharge obligations pertaining to the debtor in estate-related matters. In particular, the insolvency administrator exercises shareholder rights attached to shares in the insolvency estate, makes decisions on trade secrets and other areas of confidentiality, acts in the capacity of an employer in relation to the debtor's employees, and is responsible for the operation of the debtor's business, bookkeeping and tax compliance. Insolvency administrators are also tasked with monetizing the estate.

In reorganization proceedings, the debtor continues to hold these rights, which are subject to significant restrictions. Such restrictions include a right of secured creditors to instruct the debtor on how to manage the security, provided that such instructions are consistent with good governance. Upon the Insolvency Court's decision to authorize the reorganization, the powers of a debtor's general meeting are suspended and the insolvency administrator makes decisions without a  general meeting unless otherwise provided by the Insolvency Act. Once the reorganization plan is adopted and approved, all actions must be in compliance with it.

## What is level of disclosure of process to voting creditors?

**Insolvency proceedings**

The Insolvency Court publishes information regarding the proceedings in the publicly accessible central web-based registry of insolvency proceedings. Such information includes decisions of the Insolvency Court, filings filled with the Insolvency Court that are kept in the debtor's file and other information unless otherwise provided by the Insolvency Act.

The creditors' committee/meeting may supervise the administrator's or the debtor's activities and has a high level of access to additional information.

In a reorganization, additional information is provided to creditors to ensure voting on proposals is made on an informed basis. In particular, creditors receive prior access to the reorganization plan, reports on the reorganization plan and other material documents.

## What entities are excluded from customary insolvency or reorganisation proceedings, and what legislation applies to them?

**Insolvency proceedings**

Generally, insolvency proceedings may be commenced by or against any legal person, subject to the exceptions provided for by  Czech law.

In particular, insolvency proceedings may not be commenced against (i) the Czech Republic; (ii) a self-governing territorial unit; (iii) the Czech National Bank; (iv) the General Health Insurance Company of the Czech Republic; (v) financial market guarantee system and funds managed by it; (vi) Securities Traders Guarantee Fund; (vii) a public higher education institution and (viii) a legal person, if the state or a higher territorial self-governing unit has taken over or guaranteed all its debts before the commencement of insolvency proceedings; (ix) a financial institution, for as long as it holds a license or authorization in accordance with the special legislation governing its activities; (x) a health insurance company established pursuant to a special legal act, for the period for which it is a holder of a license to carry out public health insurance; and (xi) a political party or political movement at the time of the declared elections under a special legal regulation.

Special insolvency rules apply to banks, insurance companies and other financial institutions, which are subject to the rules set out in part two, chapter IV of the Insolvency Act and the Act on the Recovery and Resolution of Financial Institutions, both implementing the EU Bank Recovery and Resolution Directive.

## How long does it generally take for a creditor to commence the procedure?

**Insolvency proceedings**

How long it takes creditors to commence insolvency proceedings is heavily dependent on the specifics of each case. In case the petition is filed by the debtor, the debtor's management is typically quick to initiate proceedings since insolvent trading can lead to the managers being personally liable. Within hours after the insolvency petition is filed, the Insolvency Court publishes certain details of the just-commenced proceedings in the publicly accessible central web-based registry of insolvency proceedings.

Once insolvency is reported to the competent Insolvency Court, the court is usually quick to issue its decision and open the proceedings.

# Effect of Process

## Does debtor remain in possession with continuation of incumbent management control?

**Insolvency proceedings**

Subject to significant restrictions, the debtor continues to hold the management control until the decision on insolvency, and thereafter between the time of the insolvency decision and the decision on how to resolve the insolvency.

In bankruptcy proceedings, the court-appointed insolvency administrator manages estate assets and assumes the authority to dispose of the estate, to exercise rights and to discharge obligations pertaining to the debtor in estate-related matters. In particular, the insolvency administrator exercises shareholder rights attached to shares in the insolvency estate, makes decisions on trade secrets and other areas of confidentiality, acts in the capacity of the employer in relation to the debtor's employees, and is responsible for the operation of the debtor's business, bookkeeping and tax compliance. Insolvency administrators are also tasked with monetizing the estate.

In reorganization proceedings, the debtor continues to hold these same rights, which are, however, subject to significant restrictions. Such restrictions include a right of secured creditors to instruct the debtor on how to manage the security, provided that such instructions are geared toward good governance. Upon the Insolvency Court's decision to authorize the reorganization, the powers of a debtor's general meeting are suspended and the insolvency administrator makes decisions without a  general meeting unless otherwise provided by the Insolvency Act. Once the reorganization plan is adopted and approved, all actions must be in compliance with it.

## What is the stay/moratorium regime (if any)? Is the stay or moratorium worldwide?

**Insolvency proceedings**

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, filed 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) consent in writing to granting such a 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 consent in writing. Note that a debtor in liquidation cannot benefit from the moratorium regime.

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

It is also possible to file for a moratorium prior to the commencement of the insolvency proceedings (e.g., when the insolvency is impending). In such a case, the information regarding the proceeding will not be publicly available.

The moratorium applies to all creditors (including foreign creditors) and other persons. A moratorium is part of insolvency proceedings conducted in the Czech Republic, during which all claims are to be asserted via registration in the insolvency proceedings. However, even during the moratorium, it is generally possible to recognize insolvency decisions from other countries if the conditions for their recognition are fulfilled. Nevertheless,  insolvency decisions from other countries may not be recognized if they concern assets that are subject to the insolvency proceeding in the Czech Republic.

## Is there a provision for debtor in possession or rescuer financing or superpriority or priming financing?

**Insolvency proceedings**

Yes, under certain circumstances and subject to approval by the creditors' committee/meeting (Insolvency Court's approval is not necessary), new financing might be obtained (so-called "credit financing"). Creditors' claims on credit financing are preferential claims against the estate and are satisfied preferentially. The secured creditors have a priority right to provide them credit financing.

## Can procedure be used to implement a debt-to-equity swap?

**Insolvency proceedings**

Yes, in accordance with the terms of the reorganization plan and provided that the swapping creditor and the majority of creditors provide consent.

## Are third party releases available?

**Insolvency proceedings**

In general, third parties, such as co-debtors, guarantors or security providers, do not benefit from the procedure.

The creditors' rights vis-à-vis co-debtors and guarantors of the debtor also remain unaffected by the reorganization plan. Therefore, it is the responsibility of such third parties to reach an agreement with relevant creditors if the reorganization plan is of direct concern to them. Therefore, the release of third-party debtors (including guarantors) requires an express agreement with the relevant creditor.

## Are the proceedings recognised abroad?

**Insolvency proceedings**

EU member states recognize the proceedings on the basis of the EU Insolvency Regulation. The recognition by other countries may be based on domestic conflict-of-law provisions or principles or bi- or multilateral agreements.

## Has the UNCITRAL Model Law been adopted?

**Insolvency proceedings**

No.

## Can a debtor continue to carry on business during insolvency proceedings?

**Insolvency proceedings**

Yes. Generally, the operation of the debtor's business does not cease unless otherwise provided by the Insolvency Act or by another act or by the Insolvency Court's rulings. However, the actions of the debtor are limited, as mentioned above.

# Other Factors

## Are there any wrongful or insolvent trading restrictions and what is the directors' liability?

**Insolvency proceedings**

Yes. Wrongful and/or insolvent trading restrictions apply. Directors (members of the statutory body) and de facto directors, and, in exceptional cases, shareholders or supervisory board members, may be liable.

Civil liability: Damages may be available for late filing or payment after the company is deemed illiquid or over-indebted and for causing intentional damage contrary to public policy (e.g., where directors transfer assets upstream and as a result cause insolvency).

Generally, if a person fails to file an insolvency petition or if the insolvency petition is delayed, the creditor may file an action for damages. The amount of damages is calculated to be the difference between the amount of the claim filed by the creditor and the amount received by the creditor in insolvency proceedings to satisfy this claim. However, damages may not be available if it can be proven that the breach of the obligation to file an insolvency petition did not affect the amount that is owed to the creditor or that the breach was caused by facts that are beyond the control of the person which the person could not avoid. Further, potential civil liability  (especially for members of the statutory body) may occur as a result of the breach of the obligation to return consideration received from the company during the previous two years and for the payment of personal funds for the fulfillment of the company's obligations.

Criminal liability: Depending on the specific circumstances of each case, the above persons may be criminally liable. These specific circumstances include, for instance, preferential treatment of a creditor, causing insolvency, causing damage to creditors, breach of obligations pertaining to the administration of property owned by others, fraud, setting aside or hiding assets, or for violation of bookkeeping duties.

## What is the order of priority of claims?

**Insolvency proceedings**

A distinction is made between the following types of claims:

Claims against the estate – cash expenses and fees of the insolvency administrator, creditor committee's remuneration and expenses, costs associated with the maintenance and administration of the debtor's estate, taxes, charges, duty, social security contributions, state employment policy contribution, public health insurance contributions, creditors' claims on credit financing, etc.

Equivalent claims – labor-law claims of the debtor's employees, creditors' claims to compensation for damage to health, government claims, etc.

Secured claims

Other regular claims

Subordinate claims

Claims of the debtor's shareholders or members arising from their participation in the company

Claims excluded from satisfaction in insolvency proceedings

Claims against the estate, equivalent claims and secured claims may be paid in full at any time after the insolvency decision has been made.

The insolvency estate is monetized in bankruptcy proceedings. If the proceeds from the monetization of the estate are not enough to meet all of the claims, the insolvency administrator's fee and expenses are settled first, followed by creditors' claims arising during the moratorium, creditors' claims from credit financing, costs associated with the maintenance and administration of the estate, labor-law claims of the debtor's employees, and creditors' claims to maintenance and to compensation for damage to health. The remaining claims are satisfied proportionally.

After the decision approving the final report becomes effective, the insolvency administrator submits a draft order on the distribution of the estate to the Insolvency Court, which sets out how much should be paid for each claim in the revised list of registered claims. On that basis, the Insolvency Court issues an order on the distribution of the estate,  which includes the amounts to be paid to creditors. All creditors included in the distribution schedule are satisfied in proportion to the ascertained amount of their claim. Before the distribution,  unpaid claims against the estate, equivalent claims and secured claims, which may be satisfied at any time during the bankruptcy proceedings, are to be satisfied.

The subordinated claims and claims of the debtor's shareholders or members arising from their participation in the company may only be satisfied after all other claims (i.e., claims against the estate, equivalent claims and secured claims and other regular claims) are satisfied, except for excluded claims.

## Do pension liabilities have any priority over other unsecured claims?

**Insolvency proceedings**

To the extent that the employer does not pay pension contributions (statutory and voluntary), they can be registered in the debtor's insolvency as claims against the debtor and are subject to the same procedure as any other claims.

Statutory pension contributions will have priority as to claims against the estate (please see above in the section "What is the order of priority of claims?"). On the other hand, voluntary pension contributions are treated as other regular claims and have the same priority as other unsecured claims.

## Is it possible to challenge prior transactions?

**Insolvency proceedings**

Creditors are treated equally in the debtor's insolvency proceedings unless otherwise provided by the Insolvency Act. Legal acts (including omissions) by the debtor to reduce the chances that creditors will be satisfied or to favor certain creditors over others are deemed valid but ineffective (unenforceable).

There are three categories of such ineffective acts:

Legal acts without adequate consideration; which may be challenged if made within one year before the commencement of the insolvency proceedings (or three years if made in favor of a person close to the debtor)

Preferential legal acts – acts resulting in one creditor, to the detriment of other creditors, receiving greater satisfaction of their receivable than they would otherwise have received  in the bankruptcy proceedings;  which may be challenged if made within one year before the commencement of the insolvency proceedings (or three years if made in favor of a person close to the debtor)

Legal acts where the debtor intentionally worsens the satisfaction of its creditor, if the counterparty acting with the debtor knew of this intention or, in view of all of the circumstances, must have known of this intention. Such legal acts may be challenged if made within five years before the commencement of the insolvency proceedings

The ineffectiveness of the debtor's legal acts is established by an Insolvency Court ruling on an action to set aside a transaction brought by the insolvency administrator protesting the debtor's legal acts and omissions  (which may be brought within one year from the date on which the decision on insolvency becomes effective). The debtor's consideration paid (or equivalent compensation) for ineffective legal acts forms part of the estate once the ruling upholding the action to set a transaction aside becomes effective.

Depending on the circumstances, certain acts of the debtor may also result in criminal liability.

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