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## **Bankruptcy proceedings in the Czech Republic**



## INTRODUCTION

The insolvency proceedings described below is a legal proceeding concerning a debtor's insolvency or impending insolvency and the method of its solution. Act No. 182/2006 Coll., on Bankruptcy and Settlement (Insolvency Act), governs Czech insolvency procedures.

### The debtor is insolvent if:

- the debtor has more than one creditor;
- the financial obligations are over 30 days overdue;
- the debtor is unable to fulfil its obligations.

### The debtor is unable to pay its debts if:

- the debtor stopped to reimburse a substantial part of its financial obligations; or
- the debtor has financial obligations for more than 3 months overdue;
- it is not possible to satisfy any outstanding monetary claims against the debtor by enforcement or execution;
- the debtor has not fulfilled the obligation imposed by the court to provide lists enumerated in Section 104 par. 1 of the Insolvency Act.



On 1 July 2017 a new amendment to the Czech Insolvency Act came into force. One of the most significant changes introduced by the amendment relates to the so-called “coverage gap”. The concept of a coverage gap helps to indicate the moment when companies have become insolvent. The coverage gap is the difference between due liabilities and disposable funds of the debtor. A company will be considered solvent if its coverage gap is less than one tenth of its due liabilities.

**There are three main types of insolvency resolution methods:**

- reorganisation – debtor’s business activities continues according to a reorganisation plan approved by the creditors. The creditors’ receivables are paid off gradually;
- bankruptcy liquidation – debtor’s business activities are stopped and all the debtor’s assets are sold. The creditors’ receivables are proportionally satisfied through distribution of the proceeds of the sale;
- debt relief ("personal bankruptcy") is a way of dealing with bankruptcy available for debtors who are not entrepreneurs. The debtor is released from all its debts subject to the conditions approved by the creditors and the court.

**Stages of the insolvency proceedings are as follows:**

- initiation of insolvency proceedings by filing of an insolvency petition;
- the declaration of insolvency;
- decision on the method of solving the insolvency of the debtor;
- implementation of the method;
- termination of insolvency proceedings.

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## INSOLVENCY PROCEEDINGS

### Initiation of insolvency proceedings

Insolvency proceedings may be initiated only by the insolvency petition filed either by a debtor or by a creditor. The insolvency proceedings begin on the date when the insolvency petition is filed with a competent insolvency court.

The insolvency petition can be in paper or electronic form.

The insolvency court may, before the declaration of insolvency, impose an obligation to the petitioner to pay a deposit for the costs of the insolvency proceedings up to CZK 50,000.

### Declaration of insolvency

The insolvency court shall issue a declaration of insolvency if the evidence proves that the debtor is insolvent. The insolvency should be declared within a maximum of 15 days, without a court hearing.

The declaration of insolvency also contains decision on:

- an appointment of an insolvency trustee;
- an invitation to creditors to register their claims

### Legal effects of initiation of insolvency proceedings

Legal effects of initiation of insolvency proceedings are as follows:

- claims and other rights relating to the estate cannot be applied through an action;
- the right to satisfaction from the reinsurance may be exercised and acquired only under the conditions of the Insolvency Act;
- the exercise of judgment or execution may be ordered, but it cannot be performed;
- it is not possible to execute an agreement between the creditor and the debtor on deductions from wages or from other income;



- the court may order limitations on the right to set-off claims, or authorise a set-off where it is prohibited.

Set-off is generally available to the creditors in respect of mutual claims until the declaration of insolvency, or until the filing of a proposal for reorganisation. However, set-off is not possible after the declaration of insolvency unless:

- the set-off became legally possible before the declaration of bankruptcy liquidation;
- the creditor registers the claim which it wishes to set-off;
- the creditor has not acquired the claim with knowledge of debtor's insolvency or through an avoidable act;
- the creditor pays the amount by which the debtor's claim exceeds the creditor's claim, if any.

## Registration of Claims

Creditors whose receivables are secured by property of the estate under a mortgage or a title transfer security arrangement are secured creditors. Other creditors are unsecured.

Creditors have to register their claims on a special form. **You can find the application form [HERE](#).** Applications of claims and their annexes shall be submitted in duplicate to the insolvency court.

The insolvency court is obligated set out the deadline for the registration of claims in the decision on declaration of insolvency. The creditors shall register their claims in period no shorter than 30 days and no longer than 2 months. The court immediately notifies the known creditors who have their habitual residence, domicile or residence in the European Union member states except for Denmark, to register their claims. The period for register the claims runs from the day when the declaration of insolvency was delivered to the known foreign creditors. This period is usually 2 months long.

## Satisfaction of the registered claims

When all estates pertaining to the estate are monetised, it's time to satisfy the registered claims.

If the proceeds from the monetisation of the estate are not enough to meet all of the claims, following claims are satisfied in full:

- insolvency trustee's fee and cash expenses;
- creditors' claims from credit financing (provided to finance the debtor during insolvency proceedings);

- costs associated with the estate administration and maintenance
- labour-law claims of the debtor's employees;
- creditors' claims to maintenance and to compensation for damage to health.

Other claims are satisfied proportionally.

Claims secured by an asset of the debtor are satisfied from the proceeds from the monetisation of the security. If the proceeds exceed the claim, the exceeding amount is distributed between the unsecured debtors. If the proceeds are not enough to meet the secured claim, the unsatisfied part of the secured claim is deemed as unsecured claim.

## Closure of insolvency proceedings

The closure of insolvency proceedings depends on the selected insolvency resolution method.

The bankruptcy liquidation is usually terminated after the final report drawn up by the insolvency trustee is approved by the insolvency court. Although unsatisfied claims do not cease to exist, the termination of the bankruptcy liquidation is followed by cessation of existence of a corporate debtor.

Reorganisation ends with the insolvency court's decision on acknowledgement of the fulfilment of the reorganisation plan or substantial parts thereof. In cases stipulated by law, reorganisation may be also transformed into bankruptcy liquidation. In particular such situation occurs when the debtor is unable to comply with the reorganisation plan.

Debt relief ends with the insolvency court's decision acknowledging the implementation of debt relief. If the debtor complies with all obligations under the approved debt relief method, the insolvency issues an order freeing the debtor the payment of debts included in the debt relief procedure to the extent to which they have not yet been met. Debt relief can be also transformed into bankruptcy liquidation when the debtor fails to comply with debt relief conditions.



## PENALTIES FOR DENIED CLAIMS

### Penalties

In case the creditor registers a claim, which is then denied or admitted in amount of less than 50% of its originally registered amount, the entire claim is disregarded by operation of law. The court may impose the creditor to pay to the estate a penalty in the amount of the difference between the admitted amount of the claim and the registered amount.

### Liability of shareholders

Statutory bodies' members of companies are obligated to file an insolvency petition when the company is insolvent. A member of a statutory body who did not submit an insolvency petition regarding "his" insolvent company is responsible for damages or other injuries related to the breach of his obligation.

According to par. 62 of the Czech Business Act, the members of the statutory body are obliged to return the remuneration acquired according to the management service agreement or, if necessary, other benefits, for a period of two years preceding the declaration of insolvency, if:

- the insolvency proceedings were initiated on the proposal of a person other than the debtor;
- the shareholders knew or ought to have known that a corporation was in a state of imminent bankruptcy;
- the members of the statutory body did not do everything necessary and reasonably foreseeable for the purpose of avoiding insolvency.



## SOME NUMBERS REGARDING INSOLVENCY PROCEEDINGS IN THE CZECH REPUBLIC

For the first quarter of 2017, a total of 6,888 insolvency proposals were filed. The total number of insolvency proposals dropped by 8.23% against 2016.

Average satisfaction of the unsecured creditors amounts to approx. 7%.

In 58% of all companies in insolvency have sold or transferred their assets before the start of the insolvency proceedings.

There is no official evidence, therefore the above stated numbers are only an estimation made by the companies advising creditors in insolvency proceedings.

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E-mail: [czechrepublic@accace.com](mailto:czechrepublic@accace.com)

Tel.: +420 222 753 480

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