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CORONAVIRUS: FIRST AID MEASURES IN CZECH INSOLVENCY LAW

On 31 March 2020, the government of the Czech Republic approved a bill on certain measures to mitigate the impact of the SARS-CoV-2 coronavirus outbreak (also referred to colloquially as "Lex Covid"). On 1 April 2020, the bill was tabled in the House of Representatives as Bill 807.

Several of the measures proposed in the bill specifically concern corporate insolvency proceedings. These measures are exceptional not only in their contents but also as regards the timeline within which the bill has been prepared and is expected to be approved by Parliament and enter into force.

The current assumption is that the bill will become law and take effect almost immediately after Parliament is able to discuss it. The bill's impact could therefore be imminent. This article briefly outlines the proposed measures, mainly from the perspective of the debt and other financial markets.

Key Points

- Suspension of the debtors' duty to file for insolvency
- Suspension of the creditors' right to file for insolvency
- The new tool of extraordinary moratorium
- The general freezing of claw-back periods

THE DUTY AND THE RIGHT TO INITIATE INSOLVENCY PROCEEDINGS

The bill would suspend the debtor's duty to file an insolvency petition without undue delay after the onset of insolvency, as well as the associated risk of personal liability that may be incurred by directors under the Insolvency Act as the result of any such delay. The suspension is proposed to last for the duration of the currently imposed anti-epidemic emergency measures and for six months thereafter. However, the suspension should not in any case extend beyond the end of 2020.

Nevertheless, these measures will not entirely shield directors against potential liability in connection with financial distress caused by the epidemic. The bill does not propose to alter or suspend the Business Corporations Act's provision on the liability of directors of companies threatened by insolvency. Although the practical implications of the relevant provision are not very clear, it does impose personal liability where directors knew or should have known about the likelihood of insolvency and failed to act with due care so as to avert the threat of insolvency through all such measures as may have been reasonably required.

The bill also proposes to offer debtors temporary protection from insolvency petitions filed by creditors. Such petitions would not be acted upon until the end of August 2020. In practical terms, this means that the insolvency court seized of a creditor petition will not publish the petition on the on-line insolvency register and will notify the petitioner that the petition will not be acted upon pursuant to the above-mentioned legislative measures. Insolvency petitions filed in spite of these measures will not result in any procedural consequences, whether prior to the end of August or thereafter. However, the creditor will be within its rights to file a new insolvency petition after the end of August 2020.

A NEW TOOL – THE EXTRAORDINARY MORATORIUM

The upcoming weeks and months may see cases where the protection provided by the temporary suspension of the debtors' obligation and the creditors' right to file an insolvency petition will not be sufficient to sustain the operations and to protect the value of businesses jeopardised by the economic impact of the coronavirus epidemic. In particular, this situation may arise where a mortgage agreement or other security instrument allows the secured creditor to enforce the charge out of court, typically by means of a private sale or by acquiring ownership of the collateral.

For these cases in particular, the bill introduces a new extraordinary moratorium. This new tool would allow debtors who were not insolvent on 12 March 2020, but who have run into financial difficulties due to the COVID-19 outbreak, to file for an extraordinary moratorium by the end of August 2020. The moratorium would not only prevent the commencement of insolvency proceedings, but would also stay the enforcement of charges and other forms of unilateral debt collection. Unlike the "ordinary" moratorium currently regulated by the Insolvency Act, the new extraordinary moratorium would not require the debtor to obtain the prior consent of the majority of its creditors and would explicitly not restrict the debtor from utilising any state aid provided in connection with the COVID-19 outbreak. In addition, the extraordinary moratorium would enable the debtor to prioritise the payment of liabilities directly related to the operations of the debtor's business which have arisen since the extraordinary moratorium was declared over liabilities which were due and payable earlier. The extraordinary moratorium would also protect debtors from having certain long-term contracts terminated by their counterparties, similar to the protection provided under the "ordinary" moratorium.

Nevertheless, the extraordinary moratorium proposed by the bill will not provide "a free pass" by any means.

Debtors who utilise the extraordinary moratorium will be under a duty to use their best efforts to provide the best possible outcome for creditors and to prioritise their creditors' interests over their own interests or the interests of other parties. As in the "ordinary" moratorium, directors will be personally liable for any loss caused through breach of the debtor's obligations during the moratorium, including any breach in connection with the petition thereon. Unlike in the "ordinary" moratorium, set-off will not be prohibited. In relation to derivative and other financial transactions, the extraordinary moratorium will not affect (similarly to the "ordinary" moratorium) financial collateral or close-out netting provisions. The bill does not introduce any rules specifically supporting the provision of new financing which would enjoy priority ranking should the debtor eventually end up in insolvency proceedings. Since the moratorium is not notified as proceedings under the European Insolvency Regulation 2015/848, its protective effects will not apply outside the Czech Republic. If the debtor has recently made distributions to its shareholders or other affiliated parties or made related-party transactions with a similar effect (including pre-payments of intra-group loans), the debtor will not be eligible for the extraordinary moratorium, unless the funds distributed are returned to the debtor prior to the filing. In the event of any doubt as to the legitimacy of the debtor's actions, the insolvency courts will be entitled to use the full range of interim measures available to them under the Insolvency Act, including the ability to appoint an interim insolvency trustee and the power to terminate the extraordinary moratorium early. Finally, the extraordinary moratorium will trigger the public exposure related to the case file being maintained in the on-line insolvency register.

Therefore, debtors should carefully weigh the pros and cons of the extraordinary moratorium prior to deciding to apply for one.

The extraordinary moratorium will terminate upon expiry of the initial three-month period for which it would normally be ordered, unless the majority of the debtor's creditors grant their consent to an extension (for up-to a further three months). The extraordinary moratorium will also terminate if the debtor files an insolvency petition or if the court orders an "ordinary" moratorium upon a further petition by the debtor.

FREEZING OF THE CLAW-BACK PERIODS

Given that there will be a temporary "freeze" regarding entry into in the whole insolvency system, the bill also introduces a rule whereby, for as long as the debtors' obligation to file for insolvency is suspended, the running of claw-back periods relevant to actions for the avoidance of antecedent transactions will also be suspended.

EFFECTIVE DATE AND SUBSEQUENT MEASURES

These measures are expected to be passed by Parliament in the form of emergency legislation and to take effect very quickly.

Naturally, these are initial measures only which aim to quickly respond to the immediate economic impacts of the epidemic. The legislator will have to be ready to make further changes to the insolvency system. This applies both to particular parameters of the insolvency system and to fundamental reform measures which include, among other things, the implementation of EU Restructuring Directive 2019/1023.

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