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Avoidance of Antecedent Transactions and Cross-border Insolvency in the Czech Republic

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Acknowledgement

INSOL International is very pleased to present a technical paper titled “Avoidance of Antecedent Transactions and Cross-border Insolvency in the Czech Republic” by Petr Sprinz, partner, HAVEL & PARTNERS.

This paper provides members with a detailed overview of Czech insolvency law governing the avoidance of payments and other transactions in certain circumstances (and the consequences of that avoidance) effected before and during insolvency. The avoidance and recovery of transactions completed prior to the commencement of insolvency proceedings is sometimes the primary mechanism to recover and redistribute value to creditors and interested parties. When the assets to be recovered are located in another jurisdiction that adds another layer of complexity and challenge to the effort.

The information in this paper offers a very helpful practical guide to practitioners, specifically it discusses the statutory and common law authority for avoiding antecedent transactions, common defences, choice-of-law issues, disclosure and discovery issues, access (and barriers thereto) to the Czech courts, judicial assistance for and against foreign claimants and recognition issues.

INSOL International sincerely thanks Petr Sprinz for this detailed analysis and for writing this excellent technical paper.

January 2018

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Avoidance of Antecedent Transactions and Cross-border Insolvency in the Czech Republic

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Introduction

As scholars point out, in the case of insolvency or imminent insolvency, debtors tend to succumb to the feeling that affiliated persons rather than their creditors should benefit from the debtors' estate. One of the purposes of insolvency law is to avoid such transactions by virtue of rules for the avoidance of antecedent transactions. This paper should serve as a helpful, practical guide for restructuring and insolvency practitioners in relation to the rules for avoidance in the Czech Republic.

1. What are the sources and predicates – statutory, common law or otherwise – for avoiding antecedent transactions?

1.1. Sources for avoiding antecedent transactions

The avoidance of antecedent transactions is predominantly regulated by Act No. 182/2006 Coll., on Insolvency and Resolution thereof, as amended (the Insolvency Act). The Insolvency Act was enacted in 2006 and became effective as of 1 January 2008.

The Insolvency Act provides for the avoidance of transactions at an undervalue, preferences, as well as intentionally fraudulent legal acts. However, an insolvency trustee may only challenge legal acts if they curtail the satisfaction of creditors or favour certain creditors over others (providing that the term 'legal act' also covers omissions).

1.2. Avoidance of transactions at an undervalue

Legal acts without reasonable consideration are defined as legal acts under which the debtor undertook to provide performance for no consideration or for consideration with a value substantially lower than the usual value of the debtor's performance, if such acts were undertaken during the debtor's insolvency, or if they rendered the debtor insolvent.

In the case of legal acts favouring a person related to the debtor or a person belonging to the same group of companies as the debtor, there is a presumption of insolvency and it is up to such a person to provide evidence that the legal acts were not undertaken during the debtor's insolvency.

The Insolvency Act contains a list of examples of acts which are not undervalues. The list includes, without limitation, the performance of an act mandated by statutory provisions or the provision of a gift of an appropriate value.

According to case law, the creation of a security interest to secure a debt of another without any consideration is an example of a transaction at an undervalue.

1.3. Avoidance of preferences

Preferential legal acts are legal acts, as a result of which a creditor receives higher satisfaction than it would have received in the bankruptcy liquidation procedure, to the detriment of other creditors, if the act or acts were undertaken during the debtor's insolvency or if the act or acts rendered the debtor insolvent.

In the event of legal acts favouring a person related to the debtor or a person belonging to the same group of companies as the debtor, there is a presumption of insolvency and it is up to such a person to provide evidence that the legal acts were not undertaken during the debtor's insolvency.

The Insolvency Act provides a set of examples of preferences which include legal acts whereby:

a) the debtor paid a debt before it became due;

b) the debtor agreed upon a modification or replacement of its obligation to its own detriment;

c) the debtor waived the performance of its receivables from another debtor or otherwise agreed upon or enabled the cessation or the non-performance of its right; and

d) the debtor provided its assets to secure an already existing obligation (unless the security interest is established as a result of changes in the internal content of a pledged set of assets).

Also, the Insolvency Act lists the following legal acts that are not considered as preferences:

a) the creation of a security interest for which the debtor has concurrently obtained appropriate consideration;

b) a legal act undertaken:

- in the ordinary course of business;
- on the basis of which the debtor has obtained reasonable consideration or another cash benefit; and
- on condition that the legal act was not undertaken in favour of a person related to the debtor or a person belonging to the same group of companies as the debtor; and
- such other person could not recognise with due care that the legal act had rendered the debtor insolvent or that the debtor was insolvent;

c) a legal act which was undertaken during the period of a declared moratorium or after the commencement of the insolvency proceedings in accordance with the Insolvency Act.

1.4. Avoidance of fraudulent acts

Intentionally fraudulent legal acts are legal acts by which the debtor intentionally curtails the satisfaction of a creditor or creditors provided that the other party to the legal act knew or, in consideration of all circumstances, must have known of the debtor's intention.

In the case of legal acts in favour of a person related to the debtor or a person belonging to the same group of companies as the debtor, there is a presumption of insolvency and it is up to such a person to provide evidence that the person did not know about the debtor's intention.

1.5. Legal implications for challenged transactions

If the insolvency trustee successfully challenges a transaction, the transaction is considered ineffective for the purpose of the relevant insolvency proceedings. The validity of the transaction is not affected.

Persons for whose benefit the ineffective legal act was undertaken or who benefited from the ineffective legal act are required to surrender the performance from the legal act for the benefit of the insolvency estate. If the original debtor’s performance cannot be provided (e.g. the transferred asset has been transferred to a third party), adequate performance must be provided (usually the monetary value of the transferred asset).

If the successful challenge concerns a security interest, such security interest is ineffective and the status of the creditor is considered to be unsecured.

If the challenged transfer consisted of the mutual exchange of performance, the insolvency trustee is required to hand over the performance that the debtor obtained. Yet, if such performance is not recognisable (i.e. money on the account) or no longer forms part of the insolvency estate, the entitled person has a claim against the respective debtor, which is deemed a non-preferential unsecured claim.

1.6. Hardening periods

Preferences and undervalues might be challenged if they were undertaken during:

(i) the three years preceding the commencement of the insolvency proceedings, if they were undertaken for the benefit of a person related to the debtor or a person belonging to the same group of companies as the debtor; or

(ii) the year preceding the commencement of the insolvency proceedings in all other cases.

The effectiveness of intentionally fraudulent legal acts may be challenged if they were undertaken during the five years preceding the commencement of the insolvency proceedings.

1.7. Filing an action

Only the insolvency trustee is entitled to bring a legal action to challenge the effectiveness of transactions at an undervalue, preferences or fraudulent transfers in the insolvency proceedings under the Insolvency Act. The insolvency trustee may be compelled to bring an action by the creditors' committee, if the committee passes a resolution to this effect. If there are insufficient funds in the insolvency estate to cover the costs of the litigation, the insolvency trustee may make the filing of the action conditional upon the provision of adequate funding.

The legal action to challenge the ineffectiveness of transactions at an undervalues, preferences or fraudulent transfers in the insolvency proceedings under the Insolvency Act must be filed within one year of the date on which the court's decision on the debtor's insolvency became effective. The legal action must be filed with the insolvency court hearing the case in question.

2. What are the common defences?

The requirements for a successful challenge to each antecedent transaction are explained in section 1 above. A common defence is that one or more of the statutory requirements have not been fulfilled. Typically, in the case of undervalues and preferences, defendants argue that the transaction neither rendered the debtor insolvent nor was made during the debtor's insolvency. In addition to that, in the case of undervalues, defendants commonly seek to establish that the consideration provided to the debtor was reasonable.

3. Does a foreign party have standing to pursue avoidance actions in the country's courts?

Generally, any foreign party may pursue claims before Czech courts provided that the jurisdiction of Czech courts is established and Czech law acknowledges the statutory or contractual representation of the debtor. In insolvency proceedings in EU Member States, to which Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings (Recast Insolvency Regulation) applies, an automatic recognition of the insolvency practitioner is governed by Art. 21 of the Recast Insolvency Regulation. Art. 21 (2) of the Recast Insolvency Regulation explicitly entitles the (foreign) insolvency practitioner to pursue avoidance actions.

For non-EU countries, the competence of the insolvency practitioner must be assessed in each individual case. Under section 45 of Act No. 91/2012 Coll. (Czech International Private Law Act), the validity of an insolvency administrator's acts is governed by the actual registered office of the entity the administrator represents. However, it suffices when acts of the insolvency administrator are valid under Czech law.

Exceptions can be made if the acknowledgement of foreign proceedings or a foreign judgment violates public order.

It is generally mandatory to use the Czech language before Czech courts and to translate all documents (including exhibits) into Czech. Some judges in the Czech Republic may accept exhibits in English or another language, however, this is rare. In general, all procedural statements (including legal actions) must be made in Czech and courts may (and most likely will) require a certified translation of exhibits.

Foreign parties registered outside the European Union may be required to provide security for costs in accordance with section 9 of the Czech International Private Law Act. This may happen upon the request of the defendant and the amount is at the discretion of the court.

4. Can a foreign party bring a claim under foreign avoidance law directly against a transferee?

Generally, Czech courts may decide on claims under foreign avoidance law, on the assumption that the relevant Czech court has jurisdiction to hear the case. This could probably be the case where the avoidance action is related to immovable assets located in the Czech Republic. As a result, such situations are not common.

5. Who decides issues of foreign law?

Judges are considered competent to rule on issues concerning foreign law and foreign law is subject to discovery (it must be proved by the parties).

Commonly, judges will rely on the expertise of a Czech or foreign expert, often a professor lecturing on the respective foreign area of law.

6. Can a court in a foreign country seek assistance from a local court on matters of foreign avoidance law?

In general, courts in other countries may seek assistance from Czech courts if such assistance is provided for in treaties or agreements. EU law provides a general framework within the EU (except Denmark) whereas other treaties and general provisions apply in the case of other countries. In most cases, the assistance concerns taking evidence, delivery of documents or enforcement of decisions.

It should be noted that Czech courts do not provide any assistance whatsoever as far as the interpretation of Czech law is concerned.

7. Has the UNCITRAL Model Law on Cross-Border Insolvency been adopted?

The Czech Republic has not adopted the UNCITRAL Model Law on Cross-Border Insolvency. There is no legislative initiative to do so in the near future, either.

8. What does the insolvency regime provide regarding disclosure or discovery?

The Insolvency Act does not provide for any specific procedure regarding disclosure or discovery. It only assumes several rebuttable presumptions regarding certain issues of avoidance law.

Rules therefore applicable to other adversary proceedings contained in the Czech Civil Procedure Code also apply to avoidance actions.

Under the Czech Civil Procedure Code, a person having a certain document must produce it to the court upon request. For example, the duty to produce documents is very limited in comparison to the U.S. practice.

In terms of avoidance actions, generally one of the most significant issues is whether the debtor was insolvent at the time of the transaction or whether the transaction rendered the debtor insolvent. In general, it is the insolvency trustee who has to prove all elements pertaining to the avoidance action. In this respect, as indicated above, the Insolvency Act sets forth a rebuttable presumption that the debtor was insolvent in the case of transactions between related parties.

9. How are litigation fees and costs assessed?

Insolvency trustees are exempt from the payment of court fees. The submission therefore, of an action to avoid any transaction is not subject to court fees.

As far as the reimbursement of legal costs is concerned, the Czech system generally applies the '*loser pays'* rule. Accordingly, the unsuccessful party must pay the costs of legal representation of the other party (in the case of the defendant, it must also pay the court fee which the insolvency trustee did not pay due to the exemption). The costs of legal representation are set by a regulation and typically depend on the value of the dispute.

The Czech legal framework does not, however, consider the avoidance action to be an action to pay but rather an action to determine that the transaction is voidable. Thus, the costs of legal representation are fixed at a very low amount which, in conjunction with the exemption from the court fees, renders the submission of the legal action very attractive for the insolvency trustee. In the event that the insolvency trustee does not win the case, there is therefore a low risk of the trustee being required to pay a large sum in relation to the costs of legal representation.

It is not mandatory for the insolvency trustee nor for the defendant to be represented by attorneys. It is however, common for the defendant to have legal representation even if it employs an in-house counsel. Attorneys commonly charge hourly fees. Due to the low level at which legal costs are fixed, the actual costs of legal representation are generally not reimbursed in full even if the defendant succeeds.

10. Are foreign judgments avoiding antecedent transfers enforceable?

Judgments avoiding antecedent transfers handed down by an EU Member State's court (except for Denmark) are to be recognised automatically under Art. 32 of the Recast Insolvency Regulation. Such judgments are enforced in accordance with Art. 39 to 44 and 47 to 57 of Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

Judgments rendered by other states are recognised and enforced pursuant to the rules of the Czech Conflict of Law

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Alvarez & Marsal
Baker McKenzie
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BTG Global Advisory
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