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Cross-Border Restructurings in the CZECH REPUBLIC

The Czech economy has gathered steam. The GDP rose by 2% in 2014 and economists expect a further growth by 2.5% this year. However, there are still some factors which might hamper the positive momentum, in particular geopolitical developments. Miroslav Dubovsky (Weinhold Legal, Prague) and Dr. Ruediger Theiselmann (WELLENSIEK, Frankfurt) show what German companies should be aware of when it comes to restructurings in the Czech Republic.

The Czech GDP is growing, the business climate is positive – do you really expect restructuring needs there?

Theiselmann: Indeed, the Czech economy has developed quite well last year and recovered from the European sovereign debt crisis. The unemployment rate is at a very low level of 6% which stimulates private consumption and is therefore positive for the retail sector. At the same time, it needs to be highlighted that the Czech Republic very much depends on exports which represent 84% of the GDP. Hence, the situation in Russia and Ukraine is a serious risk.

How does this affect German companies doing business in the Czech Republic?

Theiselmann: The Czech automotive business and therefore foreign suppliers will suffer from lower exports to Russia. Moreover, increased competition in the retail sector leads to decreasing margins which might cause a further consolidation.

What should German companies be aware of if a Czech subsidiary is in a financial crisis?

Dubovsky: Should the Czech subsidiary be in serious financial difficulties, the primary obligation of the statutory body is to file a debtor insolvency petition. If the statutory body (its members) does not fulfil this obligation, they might be forced to return the consideration received under their executive service agreements as well as any other consideration received from the company during the previous 2 years. In case of a holding structure, under specific circumstances, even the German holding company might be obliged to guarantee the payment of the subsidiary's debts to the subsidiary's creditors.

What difficulties might German holdings face in terms of labor law when it comes to restructurings of their Czech affiliated companies?

Dubovsky: Termination of employment during restructurings and transfer of workers to other working positions are strictly regulated by labour law, brings additional costs and might also in some cases require the consent of the employee. In case of sale of a business, transfer of workers to another employer is usually involved. In such a case the employees are entitled to receive information about their transfer to another employer 30 days before it becomes effective. The transferring employer is moreover obliged to inform in advance the trade union organizations and consult with them on specific labour law questions. The employees might also decide not work for the new employer and give a notice of termination. In such case the employ-

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ment terminates on the day on which the transfer becomes effective, the notice period may therefore be much shorter than the Czech legal "standard" of two months, in extreme cases even only a few days.

How have you been involved in Czech restructuring projects?

Theiselmann: Recently, we transferred shares in the Czech affiliated company belonging to a distressed German group. In this respect, we also needed to amend the bylaws due to legislative changes under Czech corporate law. We coordinated the process for the German client and worked closely together with the local management as well as the lawyers from Weinhold Legal.

Which insolvency reasons exist under Czech law?

Dubovsky: Under Czech law, a debtor is deemed insolvent in a case of having multiple creditors and having financial obligations that are more than 30 days overdue under the condition that the debtor is not able to pay the financial obligations (so called "payment incapability"). A debtor is considered to be incapable of payments if its stops payments of a substantial part of its financial obligations, or when having any financial obligations overdue for more than three months, or when an execution against its assets was unsuccessful due to lack of assets. If the debtor is deemed insolvent, it does not necessarily mean that it must go bankrupt and cease its activities. The Czech law provides also for other methods of how to deal with insolvency that enable the debtor to continue the business, such as reorganization of the debtor.

From a Czech perspective, under what circumstances is the liquidation of a company preferable to an insolvency proceeding?

Dubovsky: Actually, under the Czech law it is not a matter of choice whether insolvency proceedings or liquidation are initiated. If an insolvency reason is given, there is an obligation to proceed with filing the insolvency petition. Moreover, the insolvency proceedings only come into question when there is not enough assets to cover all of the debts of the company. On the other hand, initiation of liquidation of a subsidiary is a business decision of the holding company. Such decision often reflects the fact that the business is unprofitable or not profitable enough for the holding company, whereas the insolvency proceedings usually refer to serious financial problems of the company.

Many thanks for the interesting discussion, Mr. Dubovsky and Mr. Theiselmann.

Miroslav Dubovsky is attorney and partner at Weinhold Legal in Prague. He focuses mainly on mergers and acquisitions, business restructurings, private equity, joint ventures and real estate, in which he handles complex national and cross-border deals.

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