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Banking & Finance

Second Edition

Czech Republic
PRK Partners

chambers.com

2019

Law and Practice

Contributed by PRK Partners

Contents

PRK Partners provides top-tier, comprehensive legal services in all areas of law from its offices in the Czech Republic – in Prague and Ostrava – as well as in Bratislava, Slovakia. Since its founding in 1993, PRK Partners has specialised in banking, finance and capital markets as a cornerstone of its legal practice. It has garnered a reputation for its excellent work on major international and domestic transactions which, for the most part, were unique due to their size or the firm's innovative approach. Its services cover a wide range of matters from project financing, syndicated loans, acquisition financing and security documentation, to model documentation, consumer loans, trade finance and treasury. Its banking and finance team (four partners, ten legal practitioners and two tax advisers) has advised, among others, Raiffeisenbank, UniCredit Bank, Komerční banka, Česká spořitelna, ČSOB, and the Prague Stock Exchange.

Authors

Jan Kohout is a partner at PRK Partners and the head of the firm's Russia desk. Jan has substantial experience in the banking sector, project financing and restructuring projects. His clients include large banks operating on the Czech market (Raiffeisenbank, UniCredit Bank, Komerční banka and Sberbank), and he also regularly advises Czech and international clients on M&As, real estate and infrastructure projects – including litigations and arbitrations in those areas. His memberships include being on the Supervisory Council of the Czech Bar Association and the Board of Directors of the Chamber of Trade and Industry for CIS countries. Jan routinely advises in Czech, Russian and English.

Norbert Hink is a senior associate specialising in banking and finance, general corporate, M&As and real estate financing. Norbert gained experience as an in-house lawyer at Raiffeisenbank, where he worked on real estate project investments and divestments and provided legal support in related financing and corporate matters. He has extensively advised Czech and foreign banks regarding project, acquisition and corporate financing, and has a particular focus on regulatory issues, notably regulation of the banking business, payment service providers and exchange offices. Norbert advises clients in both Czech and English.

Václav Bilý is a partner at PRK Partners who specialises in banking and finance, insolvency and restructuring, real estate and public procurement law. He is known for his expertise in solar energy financing, regulatory and compliance knowledge in the finance sector, model agreements and documentation for the banking sector, and real estate financing. He is a member of the advisory board for insolvency law of the Czech Bar Association. His clients include UniCredit Bank, Komerční banka, Česká spořitelna, Raiffeisenlandesbank Niederösterreich-Wien, J&T Banka and HYPO NOE Landesbank, among others. Václav routinely advises in Czech, German and English.

Tomáš Bureš is a senior associate who focuses on banking and finance, mergers and acquisitions, real estate and general corporate law. He has provided legal services to Czech and foreign banks and financial institutions in connection with the drafting and negotiating of loan financing, regulatory and compliance issues in the finance sector, model contractual documentation etc.

1. Loan Market Panorama

1.1 Impact of Regulatory Environment and Economic Cycles

The Czech economy still benefits from strong consumption, even as the global climate has deteriorated significantly and the monetary policy cycle in the US and euro area has reversed itself. Although the Czech economy has so far been notably resistant to Germany's industrial recession, domestic economic growth will slow considerably by the end of 2019.

The Czech financial market is characterised by a strong and deep banking market mainly represented by large traditional banks. In most cases, these banks have become part of large international banking groups and can draw on their group's expertise in daily business.

From 2018 to the present, the overall loan market in the Czech Republic has remained solid; the impact of the current economic situation is only marginal. The outlook for the Czech economy and the country's lending markets remains positive. Loan market players expect a slight slowdown in corporate banking over 2019 and 2020, by around two percentage points compared to 2018. A similar slowdown is expected in loans to households, primarily due to stricter regulation of mortgages and lack of affordable real estate for buyers.

1.2 The High-yield Market

Over the past year, the Prague Stock Exchange saw only a few bond issues by non-bank issuers as an alternative to a bank loan. Some were issued by the financing SPVs and secured by a parent company guarantee, and the issue terms included a number of covenants, usually less restrictive than those used in bank loans.

A number of classic corporate bonds issued by large companies were admitted for trading on a regulated market, but these do not represent a true alternative to bank loans. Also, some of the usual issuers are now large enough, have gained a sufficient rating and are seeking issue opportunities on other (larger) European markets.

In addition, the Czech Republic has seen a significant increase in bond issues from small and medium-sized companies (many without any collateral), which are benefiting from the exemption for the requirement to publish a prospectus under the Prospectus Regulation.

That being said, there hasn't been much development of a high-yield market in the Czech Republic, and borrowers still mainly rely on bank loan financing.

1.3 Alternative Credit Providers

Unlike most European countries, the Czech Republic has seen only limited growth in alternative credit providers – in the form of debt funds, equity funds, operating leasing as well as non-banking institutions. Peer-to-peer lending, along with crowdfunding, has recently emerged as an alternative route for retail and small companies to obtain financing.

Banks are beginning to recognise the impact of new technologies, especially on retail and small firms. They are taking the first steps towards developing more flexible processes and tools to face the challenge of technology-driven competitors, eg, how to integrate new payment channels, like Apple Pay or Google Pay.

1.4 Banking and Finance Techniques

It is fair to say that both local financial institutions and their clients are relatively conservative and careful. As a result, bank accounts are the favourite form of saving, and bank loan structures remain conservative. Generally, international trends such as a softening of loan terms and conditions in covenant light (cov-lite) structures are being embraced.

Virtually all local retail lending is in Czech koruna, including mortgages. Corporate lending is in Czech koruna or in euros, where this represents a natural hedge to exporters or other borrowers whose income is mainly euros.

Foreign lenders or important groups look to provide financing as a syndicate or club deal, or aim for syndication of their relevant loans to international banks; in these cases, significantly more complex and voluminous loan documentation is usually required, based on the standards made available by the Loan Market Association or by the Czech Banking Association.

Retail and small companies are more prone to explore new products that are accessible through modern electronic channels or apps.

1.5 Legal, Tax, Regulatory or Other Developments

Effective from 2014, a comprehensive recodification of civil (private) law took place in the Czech Republic, which meant rather significant changes in all areas of civil law, including in the legal rules affecting the loan market. Among the recodification's most important changes in this area were:

- allowing non-banks to issue demand guarantees (before recodification, only banks were entitled to issue this type of guarantee);
- introducing the concept of a "security agent" – which is not a lender (or co-lender) of secured claims but is merely a holder of security interests in favour of the lenders of secured claims; and
- giving secured lenders the right to use private methods of enforcement of pledges and mortgages, if agreed in writing with the provider of the security (see **6.1 Enforcement of Collateral by Secured Lenders**).

Although the recodification of civil law came into effect nearly six years ago, many questions and issues remain unaddressed by the courts, and many provisions remain ambiguous with multiple interpretations by practitioners.

The new Consumer Loans Act, which came into effect in late 2016, represents a significant change in regulation. It significantly modified the rules for providing consumer loans. In terms of licensing and regulation the state did an about-turn in its approach to the consumer loan business, changing it from a largely unregulated activity to a business which is strongly regulated and under the strict supervision of the Czech National Bank (CNB). This has resulted in many small consumer loan providers exiting the market.

In 2018 the Payment Services Directive 2 (PSD2) was implemented into Czech law, introducing, among others, new regulations addressing the vast increase in online payment services.

The new income tax legislation, effective from 1 April 2019, is worth mentioning. It introduces a general limit on the tax deductibility of excessive net borrowing expenditures. Generally speaking, the new law limits the deductibility of a company's net interest (ie, interest expenses incurred minus interest income received) for corporate income tax purposes to the larger of either 30% of adjusted EBITDA of the debtor or CZK80 million.

2. Authorisation

2.1 Authorisation to Provide Financing to a Company

Authorisation requirements for providing loan financing to companies incorporated in the Czech Republic differ, depending on whether the loan provider is a bank or a non-bank.

Generally, banks can provide loan financing in the Czech Republic based on a banking licence. There are three basic options depending on where the respective bank is seated:

- banks seated in the Czech Republic provide loan financing under a Czech banking licence granted by the CNB. The Czech banking licence is granted based on an application submitted to the CNB;
- banks seated outside the Czech Republic in a country that is not an EU member state or a member state of the EEA (a "non-member state") may only provide loan financing in the Czech Republic as a permanent business through a branch established in the Czech Republic holding a Czech banking licence; and
- banks with a seat in an EU member state or a member state of the EEA (a "member state") that hold a licence for providing loan financing in the respective member state may provide loan financing in the Czech Republic based on the licence obtained in a home member state through passporting rights. If a bank from a member state intends to provide loan financing in the Czech Republic on a permanent basis, it must establish its branch in the Czech Republic for this purpose.

Non-banks may provide loan financing to Czech companies without any special licence or permission. If they intend to provide loan financing as a permanent business, they only have to meet certain general requirements (particularly capacity and a clean criminal record) and notify the local administrative authority of the commencement of this business. No regulatory requirements are stated for providing loan financing to companies by a non-bank on an irregular and ad hoc basis (ie, not as a regular business).

3. Structuring and Documentation Considerations

3.1 Restrictions on Foreign Lenders Granting Loans

Foreign lenders intending to provide debt financing to Czech borrowers are not generally subject to any additional restrictions relating to the granting of loans (for regulatory criteria applicable to lenders, see **2.1 Authorisation to Provide Financing to a Company**).

3.2 Restrictions on Granting Security to Foreign Lenders

There are no specific restrictions on the granting of security or guarantees applicable only to foreign lenders.

3.3 Restrictions and Controls on Foreign Currency Exchange

There are no exchange controls, restrictions or other concerns regarding foreign currency exchange in the Czech Republic.

3.4 Restrictions on the Borrower's Use of Proceeds

Parties usually agree contractually on the permitted use of funds. Aside from contractual restrictions on the borrower's use of proceeds for a specific purpose, borrowers are also obliged to use the proceeds from loans and debt securities in accordance with international sanctions imposed by the EU and UN.

Under Czech anti-money-laundering legislation, banks and other financial institutions are obliged to identify their clients (including their ownership structure and the real owner) and the intended purpose of the transaction; they are also obliged to inform the authorities of suspicious transactions.

Another limitation on the use of proceeds may arise from the Czech rules on financial assistance (financing of, or

providing security for, the acquisition of own shares). Such financial assistance is generally allowed provided the legal requirements are fulfilled ("whitewash procedure"). On the other hand, the whitewash procedure can limit borrowers to such an extent that, in practice, they tend to avoid using the proceeds from loans as financial assistance.

3.5 Agent and Trust Concepts

A new Civil Code came into effect in 2014, introducing the concept of "security agent" (trustee who does not necessarily need to participate in the loan). However, this legal concept is generally not considered to be satisfactory (first of all, the Civil Code fails to define the rights and duties of a security agent towards the security interest or how it can be replaced), nor has it been tested by the court.

Therefore, in practice the concept of "parallel debt" is preferred (the security agent is a joint and several creditor along with all other creditors of the syndicated loan). This only works if the security agent participates in the loan. Although parallel debt structures are generally recognised in the Czech Republic, so far, they have not been subject to court scrutiny.

3.6 Loan Transfer Mechanisms

Under Czech law, loans are generally transferred to new lenders through an assignment of the loan agreement as a whole (rights, including receivables, and obligations). Defaulting loans are usually transferred through an assignment of receivables.

Loans designed for syndication usually contain a sample assignment agreement, to be used in the event that there are any changes in participating lenders. The assignment requires the consent of the original lender and new lender (the obligors may give their consent in advance in the facilities agreement); however, in practice, the obligors and the facilities agent are usually parties to the assignment agreement.

Accessory security rights transfer automatically with the assignment of the loan. Since certain additional obligations from the security package (typically patronage investors' obligations) would not pass automatically to the new lender, certain security agreements are usually assigned to the new lender (in case of bilateral loans) or to the new security agent by way of an assignment of the security agreement.

3.7 Debt Buy-back

Buy-back of debt is not forbidden to sponsors or the borrower, although for the borrower, such buy-back would generally be considered as a prepayment of the loan.

In practice, debt buy-back by the sponsors is only permitted in exceptional cases, by contractual arrangement (for details of such assignment, see **3.6 Loan Transfer Mechanisms**, above). Debt buy-back by the sponsor may result in the application of thin capitalisation rules, which may have a negative tax effect for the borrower.

3.8 Public Acquisition Finance

Under Czech law, bidders are required to describe "certain funds" (including the method of financing) in the offer document that is submitted to the CNB for approval. The CNB may ask the bidder to provide evidence that the funds are sufficient for financing the public takeover, as well as provide evidence of their origin.

In other acquisition transactions, "certain funds" provisions are not mandatory, but may be used as a contractual arrangement (such arrangements are not usual, however).

In terms of documentation, the type and volume of the documentation depends on the circumstances.

Czech banks frequently provide debt financing on the basis of in-house standard documentation, which may be considered "short form". On the other hand, both Czech and international banks increasingly refer to "long-form" documentation, which corresponds to the standards provided by the Loan Markets Association and the Czech Banking Association – in particular, in the case of large-scale financing or when the intention is a syndication of lending engagements.

In terms of public M&A (takeover) transactions, no public filing or other disclosure of the underlying financial documentation is required.

4. Tax

4.1 Withholding Tax

Repayments of principal under loan transactions do not represent taxable income and are generally not subject to withholding tax.

Interest paid to Czech tax residents is not subject to any withholding tax (with the exception of certain products offered by banks to private individuals). Interest payments have to be taken into account for the purposes of the (corporate) income tax of the creditor and reflected as taxable income. When the creditor is an individual taxpayer who is not obliged to keep accounting books, interest is a tax-deductible expense only once it has been paid by the debtor. For accounting purposes, interest must be accrued in accordance with the matching principle (ie, all income and expenses should be properly accrued and deferred).

Interest paid abroad to Czech tax non-residents is subject to a 15% withholding tax, which can generally be reduced or eliminated by virtue of an applicable double-tax treaty, or exempt under the EU Interest and Royalties Directive. EU/EEA tax residents receiving interest income are allowed to

apply relevant expenses in their annual (corporate) income tax return.

Interest paid to tax residents who reside in offshore locations that have not concluded a double-tax treaty or agreement with the Czech Republic on exchange of information related to income tax matters, or that have not become signatories of a multilateral instrument allowing for the exchange of information related to tax matters, are subject to a final withholding tax of 35%.

Interest payments made to or collected by lenders with a permanent establishment in the Czech Republic need to be reviewed on a case-by-case basis to determine whether withholding tax applies.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Generally, there are no stamp duties, registration or similar duties imposed in the Czech Republic in respect of loan agreements, credit transactions and related security documents other than public notarial fees, upon verification of documents, registration of security assets, issuance of excerpts and certificates, etc.

4.3 Usury Laws

There are no regulatory limitations on interest charged to customers (borrowers).

However, there are certain basic limitations under Czech civil law prohibiting "usury" (*lichva*) and potentially imposing criminal law sanctions.

From a Czech tax point of view, interest charged between related parties should be determined at arm's length; otherwise, a taxable benefit may arise for both parties involved or excessive interest costs may be treated as tax non-deductible expenses for the debtor.

Moreover, the tax deductibility of interest payments on debt finance from related parties and associated financial costs may be limited by means of thin capitalisation rules, based on which interest payments on the amount of related-party debt finance exceeding four times the borrower's equity (or six times if the debtor is a bank or an insurance company) and the same portion of associated financial costs are tax non-deductible for the borrower.

By means of the recent amendment of Czech income tax legislation a general limit on the tax deductibility of excessive net borrowing expenditures has been introduced, based on which the net interest of a company (ie, interest expenses incurred minus interest income received) will be deductible for corporate income tax purposes only up to the larger of either 30% of adjusted EBITDA of the debtor or CZK80 million.

5. Guarantees and Security

5.1 Assets and Forms of Security

The typical collateral package includes guarantee, patronage or subordination, security interest over shares (interest), real estate, equipment and inventory, bank accounts, trade receivables, insurance claims, and issuance of a blank promissory note (optionally with the aval of sponsors). Less typical is security interest over intellectual property and enterprise. Pledge over interest in a co-operative is permitted by law; however, it is rarely used in practice.

Generally, collateral is created in the form of a pledge; receivables may be pledged or assigned for security purposes. Both pledge and assignment are created by agreement. As a rule, the establishment of security is usually accompanied by a negative pledge to the assets serving as security.

Ownership Interest in a Limited Liability Company

A pledge over ownership interest is perfected at the moment of its registration in the commercial register (based on an agreement with notarised signatures).

The application for registration is to be filed in the prescribed form to the respective court maintaining the commercial register. Alternatively, notaries public may register the pledge in the commercial register within a few hours, if the pledge agreement is entered into in the form of a notarial deed.

Shares in a Joint Stock Company

A pledge over share certificates is perfected at the moment of handover of the shares to the pledgee. Registered share certificates must be endorsed in favour of the pledgee.

A pledge over book-entered shares is perfected at the moment of registration in the respective evidence (maintained by Central Securities Depository Prague or all larger banks).

A pledge over shares (of all types and natures) may be perfected without significant time delay and without any significant costs.

Bank Accounts, Insurance and Receivables

Security over cash in a bank account and security over insurance qualify as security over receivables under Czech law.

Neither in the case of a pledge, nor in the case of an assignment is any special form required. However, under the recently adopted Civil Code, the pledge over receivables that is entered into in the form of a notarial deed and registered in the register of pledges maintained by the Czech Notarial Chamber ("pledge register") has priority over any security that is not registered.

The pledge/assignment of receivables is effective towards sub-debtors upon their notification.

Real Estate
A real estate mortgage is perfected at the moment of its registration in the cadastral register.

The cadastral office is obliged to wait 20 days from the filing of the application and then usually registers the mortgage without additional delay.

Inventory and Equipment
A pledge over movable assets (including inventory and equipment) is in practice created based on an agreement in the form of a notarial deed and is perfected upon its registration in the pledge register.

It is practical to pledge inventory as a collective thing, ie, to create a floating charge. In the pledge agreement, the inventory is usually identified in generic form, by referring to the entire inventory and/or equipment located at a specified location at a given time.

A pledge over aeroplanes and their parts is perfected upon registration in the aircraft register.

Enterprise
A pledge over enterprise is created by a notarial deed and is perfected by registration in the pledge register.

Blank promissory note (optionally with the aval of sponsors)
A promissory note may substantially accelerate the collection of a defaulting loan. The court will (in a special kind of proceedings) only prove the existence of the promissory note, rather than proving the existence of debt from a loan (as in usual court proceedings).

Intellectual Property
Pledge over intellectual property is generally perfected at the moment of its registration in the respective register (eg, register of trademarks).

5.2 Floating Charges or Other Universal or Similar Security Interests

Czech law permits a security interest created as a floating charge over a collective thing; it may be created over an enterprise of a company or inventory.

An "enterprise" is defined as a set of all the assets and liabilities belonging to an entrepreneur that are used by the entrepreneur to operate their business as an aggregate. When pledging an enterprise, the pledge applies to the individual things that are part of the enterprise, wherever they are.

A pledge over an enterprise is created by agreement in the form of a notarial deed and is perfected by registration in the pledge register.

5.3 Downstream, Upstream and Cross-stream Guarantees

Under Czech law, it is generally possible to give downstream, upstream and cross-stream guarantees and other security. However, these guarantees are subject to financial assistance. For further details, see **3.4 Restrictions on the Borrower's Use of Proceeds** and **5.4 Restrictions on Target**. For information on the consent of the respective corporate bodies, see **5.5 Other Restrictions**.

5.4 Restrictions on Target

In the Czech Republic, a business corporation may not provide advance payments, loans or credit for the purpose of acquiring its business shares and/or it may not provide security for these purposes ("financial assistance") if this could result in its insolvency. However, financial assistance may be provided if the conditions set by the law and the memorandum of association (or articles of association) are fulfilled. The conditions vary depending on whether financial assistance is provided by a limited liability company or a joint stock company.

5.5 Other Restrictions

Corporations are obliged to inform, under certain circumstances, the supervisory body or supreme body of the corporation about providing security for the debts of related parties. The supreme or supervisory body may prohibit the corporation from providing security to its related party, if it is not in the interest of the corporation. Breach of these rules would lead to liability for damages on the part of the respective members of the corporate bodies. As the new Civil Code has been in force for only five years, there is no clear case law as to whether this would jeopardise the security or not.

Except for registration fees and notary fees, if applicable, there are no significant costs associated with providing security.

5.6 Release of Typical Forms of Security

The typical forms of security are accessory in nature and the security basically ceases to exist by operation of law upon repayment of the secured debts in full. The pledgee (mortgagee) usually issues a quittance regarding the repayment of secured debts for the purpose of the deletion of security rights from the respective registers.

A promissory note issued as security is typically returned to the issuer or shredded.

5.7 Rules Governing the Priority of Competing Security Interests

The priority of competing security interests is in general stipulated by law; however, this may be modified contractually.

By virtue of the law, security interests created by registration in public registers have priority over those not registered. However, this would in practice only be relevant in the case of a pledge of receivables, since the other important types of security are created exclusively by registration in public registers.

The Civil Code further stipulates that security interests created earlier in time rank in priority over those created later in time, although this general rule has exceptions.

Receivables may be subordinated by an agreement between the senior creditor, the debtor and the junior creditor.

In insolvency proceedings, if the subordination agreement satisfies the conditions set forth by Czech insolvency law, the subordinated debts will be settled after full satisfaction of all other claims registered in the insolvency proceedings.

6. Enforcement

6.1 Enforcement of Collateral by Secured Lenders

A secured lender may generally enforce its collateral if the debts secured by that collateral are not settled when they become due and payable. Security documents may set out additional conditions for the enforcement of a respective security interest. One exception is non-accessory (demand) security instruments (eg, demand guarantees), which are typically enforceable irrespective of whether a payment default under an underlying (secured) relationship occurred or not.

Loans can be enforced if the monetary debts under the loan are not settled when they become due and payable, irrespective of whether on the original date or following an acceleration. Enforcement of the loan can also be triggered by a non-payment default, but the loan must first be accelerated by the lender for such non-payment default in order for the lender to start enforcement of the loan.

Lenders may enforce loans:

- by means of a general enforcement procedure against the borrower; or
- by means of enforcement of the collateral provided to secure the loan (whether by the borrower itself or by a third party).

General Enforcement Procedure

In order to start the general enforcement procedure against the borrower, a lender must obtain an "execution title", which is a court decision or an arbitral award declaring that the borrower is obliged to pay the respective debts under the loan. Alternatively, it is possible for the borrower to grant consent for the enforcement of its debts under the loan in advance in a specific agreement drawn up by a notary public. The enforcement itself may be realised using one of two possible methods:

- judicial enforcement by the court and its employees; or
- enforcement carried out by semi-private bailiffs (executors).

In practice, the latter alternative is much more commonly used, as it is far more efficient.

The executor searches for the debtor's property and is solely responsible for choosing the most effective means of execution. This differs from a judicial enforcement, where the lender itself must choose and propose the particular property of the debtor to be subject to the enforcement.

Enforcement of Collateral

Applicable methods and procedures of collateral enforcement vary, depending on the type of collateral and the agreement between the lender and collateral provider. There are two general categories of collateral enforcement methods:

- methods that involve a public authority where the collateral is enforced in a procedure held by, or under control of, a public authority or a person entrusted with public authority, namely a court, private executor or an auctioneer organising public auctions ("public enforcement"). These methods include public auctions and sales of the pledge/mortgage by a court or executor in a court auction. Typically, for these methods of public enforcement, the lender needs to possess an execution title to be able to initialise such enforcement; and
- private methods of collateral enforcement are those where the enforcement procedure is in the hands of the lender ("private enforcement"). However, this does not mean that the lender is forbidden from using the services of third parties. The use of such private enforcement methods is allowed, especially to enforce pledges and mortgages where the parties have agreed in writing to such enforcement methods. The possibility for a private enforcement of pledges/mortgages was enacted relatively recently, meaning that methods of private enforcement are still developing, and as yet, there is no single generally accepted or preferred method. However, typical types of private enforcement of a pledge/mortgage include:
  (a) direct sale;
  (b) voluntary (private) auction; and
  (c) tender.

A secured lender may also be entitled, if so agreed in writing with the owner of the pledge/mortgage, to take on the title to the pledged/mortgaged property at a price that has been fairly determined at the time of the enforcement. One key point is that, for a private enforcement of a pledge/mortgage, the secured lender does not need an execution title.

Guarantees/Suretyship

Accessory guarantees (suretyships) are enforceable against guarantors if the secured debts are not paid by the primary obligor at maturity. Sometimes, a written notice to pay must also be delivered to the primary obligor in order for the lender to be entitled to request payment under an accessory guarantee. On the other hand, the enforcement of demand guarantees does not depend on non-performance under the underlying (secured) relationships; only the conditions and requirements that have been expressly set out in the guarantee must be met by the lender (beneficiary) for the demand guarantee to be enforced.

Mortgage and Movables Pledge

A mortgage over real property – as well as a pledge over movables – may be enforced by a private enforcement if so agreed between the secured lender and the pledger/mortgagor. Such agreement is also binding on every subsequent owner of the pledged/mortgaged property.

Receivables Pledge

In relation to a pledge of receivables, no specific enforcement procedure is standardly used. The secured lender merely has the right to claim and collect payments under pledged receivables directly from the debtor of these receivables ("sub-debtor").

6.2 Foreign Law and Jurisdiction

Czech conflict of laws rules (ie, the Rome I EU regulation) generally permit the parties to a contract to choose a foreign law to govern the contract. This general rule is only limited by standard restrictions, such as the application of overriding mandatory provisions of Czech law or inapplicability of a contract law rule due to incompatibility with the public order of the Czech Republic.

It is worth noting that even if a security agreement concerning a property located in the Czech Republic (or existing under Czech law) is governed by a foreign law, there may be some principal issues relating to the security interest and its perfection that will still be governed by Czech law according to conflict of laws rules. In relation to local real estate or movable assets located in the Czech Republic, Czech law determines issues such as:

- the perfection of the security interest;
- the content of the security interest if it is a right in rem; or
- questions relating to its enforcement or termination.

To avoid noncompliance of security documents under foreign law with Czech law governing such issues, the standard market practice is to base security interests over Czech "local" assets on Czech law security documentation.

In obligations or other property matters, Czech courts generally recognise the submission to a foreign jurisdiction based on a jurisdiction choice clause. If the foreign jurisdiction choice clause is agreed for a specific matter, the Czech court cannot have jurisdiction in that matter, except if:

- the participants agree that they do not insist on the application of the jurisdiction choice clause;
- the foreign decision could not be recognised in the Czech Republic (this is, for example, in matters where Czech courts have exclusive jurisdiction, such as matters related to rights associated with real estate located in the Czech Republic);
- the foreign court refused to rule on the case; or
- the jurisdiction choice clause is contrary to Czech public order.

6.3 A Judgment Given by a Foreign Court

In terms of enforcement of foreign court judgments in the Czech Republic, a distinction is made between a judgment from an EU member state and from a country that is not an EU member.

Court Judgments from EU Member States

Recognition and enforcement of judgments from other member states of the European Union are governed in particular by the Brussels I bis Regulation. Under this regulation, judgments from the other EU member states are generally recognised and enforced in the Czech Republic without a retrial of the merits of the case and without any additional proceedings.

Besides the Brussels I bis Regulation, the EU Regulation establishing the European Enforcement Order (EEO) may be applied to the enforcement of judgments from EU member states (except for Denmark) on certain uncontested payment claims as specified in the regulation. This regulation introduces a simplified method of enforcement of judgments on such uncontested claims and an EEO is treated in the Czech Republic as if it were issued by a Czech court.

Court Judgments from Non-EU Member States

The enforceability of judgments from countries outside the European Union is generally regulated by Czech national law (rules of international jurisdiction and enforcement), which may be modified, depending on the country, by applicable multilateral or bilateral conventions and treaties.

In relation to judgments of the courts of Norway, Switzerland and Iceland, the 2007 Lugano Convention concluded between these countries and EU member states introduces

more or less the same regime of recognition and enforcement as applicable under the Brussels I bis Regulation.

According to Czech national law, judgments of foreign courts are enforceable in the Czech Republic without a retrial of the merits of the case if they have become final (in legal force) according to the confirmation thereof by the corresponding foreign authority and if they have been recognised by the Czech authorities. In property matters, the recognition of a foreign decision generally does not take the form of a special ruling or finding. Instead, it is, in general, simply sufficient for the respective Czech court to take into account the foreign decision in the same matter as if it were the decision of a Czech court. Recent decisions of Czech courts, however, tend to limit enforcement of foreign judgments to judicial enforcement only.

Czech courts would refuse to recognise and enforce a foreign judgment especially if:

- the matter belongs to the exclusive jurisdiction of the Czech courts;
- there are pending proceedings in the same legal matter before a Czech court, commenced earlier than the foreign proceedings which led to the foreign judgment;
- a Czech court has issued a final judgment in the same legal matter, or a final decision in the same matter was issued by an authority of a foreign country and recognised in the Czech Republic;
- the foreign authority deprived the party – against whom the decision is to be recognised – of the possibility to properly take part in the proceedings;
- the recognition is contrary to public order in the Czech Republic; or
- reciprocity is not guaranteed by the issuing country (reciprocity is not required if the judgment is not directed towards a Czech citizen or entity).

Arbitral Awards

The Czech Republic is a signatory of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards; therefore, all arbitral awards issued in another country that is a signatory to this convention will be recognised and enforced in accordance with the rules of the convention.

The recognition and enforcement of arbitral awards issued in countries that are not signatories of the New York Convention are subject to the rules of Czech national law (conflict of laws rules), unless they are modified by a bilateral treaty with a particular country. According to Czech national regulation, arbitral awards issued in a foreign country will be recognised and enforced as Czech arbitral awards, if reciprocity is guaranteed. Reciprocity is also considered to have been guaranteed if the foreign country generally declares that foreign arbitral awards are enforceable under the condition of reciprocity.

The recognition of a foreign arbitral award is not generally declared by means of a special judgment. A foreign arbitral award is recognised by the fact that it is taken into account as if it were a Czech arbitral award.

6.4 A Foreign Lender's Ability to Enforce Its Rights

Restrictions and impediments on a foreign lender enforcing a loan or a security agreement in the Czech Republic are of a purely technical or administrative nature. In property claim actions initialised by a foreign citizen or entity residing or seated abroad (unless they are domiciled in an EU or EEA member state), Czech courts may request, at the proposal of a defendant, that the claimant makes an advance payment for the cost of the proceedings. In addition, Czech courts will request a translation of all non-Czech documents submitted in the proceedings.

7. Bankruptcy and Insolvency

7.1 Company Rescue or Reorganisation Procedures Outside of Insolvency

Czech law does not currently recognise any company rescue or reorganisation procedures apart from insolvency proceedings; these therefore need the consent of all creditors. Nevertheless, a new Act reacting to Directive (EC) 2019/1023 on pre-insolvency restructuring is under preparation.

7.2 Impact of Insolvency Processes

Insolvency proceedings commence on the day the insolvency filing is received by the competent court. The court promptly announces the commencement of the insolvency proceedings through the insolvency register (accessible via the internet). From this moment, insolvency proceedings are effective towards third parties. The insolvency court will decide whether the debtor is indeed insolvent within seven days from the commencement of the insolvency proceedings and, usually simultaneously or after a brief delay, will decide on how to resolve the insolvency. This could be by bankruptcy (sale of the debtor's assets and proportional satisfaction of the creditors), or a reorganisation (for corporations), or debt relief (for individuals).

The impact of the insolvency proceedings varies according to the actual stage of the insolvency proceedings.

Once insolvency proceedings have commenced (ie, upon announcement of the insolvency filing), the following limitations apply to lenders enforcing their rights:

- a lender may only enforce its receivables through registering them in the insolvency proceedings by the stated deadline;

- new security may only be perfected under the insolvency rules, which in practice means only loan agreements and their security entered into by the insolvency administrator (or, under special conditions, the debtor) after the commencement of the insolvency proceedings; and
- existing security may be enforced only by registering the secured receivable in the insolvency proceedings by the stated deadline.

Once the decision on bankruptcy is announced, the insolvency administrator replaces the debtor's management.

A set-off of receivables is allowed after commencement of the insolvency proceedings. After the court decides on the debtor's insolvency, a set-off is generally possible under specific, more stringent, conditions.

Any person profiting from invalid legal conduct is obliged to return the profit to the insolvency estate. In general, any conduct which impairs the possibility that creditors' receivables will be satisfied or which gives preference to certain creditors over others, may be invalid, if it was done in favour of a related party in the last three years before the commencement of the insolvency proceedings. The profit is to be returned upon the decision of the insolvency court and any counter-claim resulting from the invalid conduct may not be set off.

7.3 The Order Creditors Are Paid on Insolvency

Claims against the estate, and similar claims, may be satisfied at any time during the insolvency proceedings, in any case, preferentially before other receivables. These are claims that have arisen after the commencement of the insolvency proceedings (or after the court's decision on the insolvency) and are satisfied in the following order:

- administrator's fee and expenditures;
- receivables from supplies of energy, raw materials and other goods during the moratorium;
- receivables from loan financing provided after the commencement of the insolvency proceedings;
- (proportionally) costs of maintenance of the estate and receivables of the debtor's employees;
- alimony and child support by virtue of law;
- satisfaction of claims of damage to health; and
- (proportionally) tax and social security claims and other claims against the estate.

Secured creditors are paid at any time during the insolvency proceedings from the proceeds of the realisation of the security. Such creditors may propose the method for realising the security; however, under certain conditions, they may be obliged to pay the costs of the proposed realisation. Secured creditors receive the proceeds from the realisation of the assets serving as security after the deduction of:

- costs of maintenance of the asset (maximum 5%);
- costs of realisation of the asset (maximum 4%);
- security administrator's fee (maximum 2%); and
- the property manager's receivables from the management of the residence in the event that a residential unit is realised.

The following claims are not satisfied at all: interest, default interest and contractual penalties accrued or due after the court's decision on insolvency, receivables from donation agreements, non-contractual sanctions against the debtor's assets, and the costs of the participants in the insolvency proceedings.

The remaining claims are satisfied from the sale of the debtor's assets after the insolvency court has approved the administrator's final report and payment schedule.

7.4 Concept of Equitable Subordination

Since Czech law does not recognise the concept of equitable subordination, as a rule, lenders contractually subordinate shareholder loans to their loans. For details regarding the subordination of claims, see **5.7. Rules Governing the Priority of Competing Security Interests**. Czech law does recognise the subordination of shareholder claims that have arisen in connection with shareholders' participation in the corporation. Such subordination is narrowly applied, eg, claims from shareholder loans would have to be subordinated contractually.

7.5 Risk Areas for Lenders

The key impact of insolvency proceedings is a significant delay in the enforcement of receivables, if they are enforced at all. Despite recent legislative changes the average recovery rate remains low – for secured creditors it is slightly above 20% for bankruptcies and just above 60% for reorganisations.

In addition, any payments – or the granting of security to lenders – may, upon the opening of the insolvency proceedings, be subject to a possible clawback. The clawback can, under certain circumstances, apply even to receivables that have arisen as much as three years before the commencement of the insolvency proceedings (actio pauliana).

The insolvency administrators review the registered receivables very rigorously and generally tend to refuse certain types of registered receivables (eg, contractual penalties). The creditors are then forced to initiate lengthy court proceedings in order to have those receivables included in the list of registered receivables.

8. Project Finance

8.1 Introduction to Project Finance

Project finance has been developing in the Czech Republic since the early 1990s, following the fall of the communist regime. It is used mostly for real estate projects (residential, office, retail, logistics or industry) and energy projects (renewable energy sources or conventional plants). Public-private Partnership (PPP) structures for projects in the Czech Republic remain marginal. Most PPP projects that have been implemented are relatively small projects realised at the municipal level.

The types of project finance transactions realised have changed over time, as a result of a number of factors. For example, the end of the 2000s saw a boom in renewable energy projects (especially solar ones) triggered by the introduction of a generous state subsidy. Following a gradual restriction on this state subsidy, beginning from 2011, the number decreased dramatically. These days, residential real estate projects are especially attractive to investors, as the price of residential real estate has skyrocketed in Prague and other big cities in the Czech Republic. That said, any increase in the construction of new residential projects is hampered by a lack of capacity on the part of construction companies.

Project finance in the Czech Republic does not fall under any special legal regulations. Generally, it is governed by the same rules and instruments applicable to other types of financing. However, depending on the sector, it will be necessary to take into account some additional special laws and regulations, such as laws related to zoning, construction, energy, public procurement or environmental law.

8.2 Overview of Public-Private Partnership Transactions

PPP projects are not that common in the Czech Republic, with the country ranking in the bottom half of EU member states in terms of the number and size of PPPs. No significant PPP project at the national level has been successfully completed.

The situation is a bit different at the municipal level, however, where PPP projects have been gradually gaining popularity. Unlike national projects, which tend to be large and costly, projects at the municipal level are usually small or mid-size – and therefore less financially demanding and risky – which can be more attractive for private investors. Another factor is that the municipal officials, who tend to be long-standing residents of the towns/cities they represent, are able to make decisions with more of a long-term and strategic perspective than top-level politicians, whose tenures are often shorter. Municipalities tend to use PPPs for the following types of projects: construction of sports facilities, parking lots, water and heating supply, public transport, healthcare and public lighting.

The key Czech law applicable to PPP projects is the Act on Public Procurement (the Act), which regulates procedures of public procurement, including the granting of concessions. These are the procedures under which private partners are chosen for PPP projects. In addition to the Act, many other regulations from numerous areas of law also apply to the implementation of PPP transactions in the Czech Republic, depending on the economic sector and the specific type of PPP project, but in principle they are the same as for other types of investment/construction projects.

The basic structure of PPP project financing in the Czech Republic does not differ greatly from that generally used in private projects. However, as the main project property in a PPP project remains in the ownership of a public partner, banks financing the SPV established by private investors for realisation of the PPP project cannot ask for the standard scope of collateral. The only assets the banks can use as collateral are the claims of the SPV regarding future income from the project.

8.3 Government Approvals, Taxes, Fees or Other Charges

As no specific legal regulation applies to project finance transactions, no special government (public authority) approvals are necessary and there are no special taxes, fees or other charges to be paid. The same rules and principles generally apply as for other types of financing.

Nevertheless, it may be necessary to obtain specific regulatory approvals in connection with the underlying (financed) project itself, depending on the type of project, such as zoning, building and occupancy permits, etc, or special industry sector approvals or licences (eg, energy business licences). Where the investor in a project is a public authority or other entity (co-)financed from public funds or where a project is (co-)financed from public funds, laws of public procurement and public subsidies (state aid) will also apply.

There is no general obligation to register or file project finance transaction documents with any government body. However, most public law entities and institutions (including the Czech Republic itself, regions, municipalities, institutions established by the state, regions or municipalities or companies controlled by the same, etc) are obliged to publish agreements and contracts (with some exemptions) to which they are a party in the Contracts Register.

Registrations in various registers (eg, Cadastral (Real Estate) Register, Commercial Register, Pledge Register, etc) may also be necessary for the perfection of certain security interests; however, this is a general provision of law, and it is irrelevant whether the creation of a security interest is being made in connection with a project finance transaction or other type of financing.

As regards the governing law of transaction documents, the majority of loan agreements relating to project finance in the Czech Republic are governed by Czech law. In much less frequent cases where a Czech project is financed by a foreign bank, such a bank sometimes insists on using a loan agreement that is governed by its home law (most often Austrian, German or English law). Nevertheless, the security documents relating to assets located in the Czech Republic are mostly governed by Czech law, even in such foreign-bank financed transactions, for the reasons mentioned in **Section 6. Enforcement**.

8.4 The Responsible Government Body

The Ministry of Industry and Trade is the central state administrative body responsible for a unified policy on raw materials, exploitation of mineral resources, energy, heating, the gas industry, and the mining, treatment and refining of raw materials.

The Ministry of Industry and Trade closely co-operates with the Ministry of the Environment, which is the central state administrative body for carrying out state geological services, protecting the geological environment, including the protection of mineral resources and groundwater, geological work and ecological supervision of mining, and the environmental impact assessment of activities and their consequences, including those which transcend national borders.

The most important laws regulating these areas are to be found in the:

- Energy Act;
- Act on Energy Management;
- Mining Act;
- Fuel Act;
- Act on Emergency Oil Reserves and on Resolving of Oil Emergencies; and
- Atomic Act.

8.5 The Main Issues When Structuring Deals

As with any jurisdiction, there are always multiple legal and non-legal issues and risks that must be considered when it comes to project finance, depending on the type and nature of the project, SPV(s) and investors realising the project and legal environment, among other factors. Lenders in project finance transactions typically examine the following main issues and risks:

- legal titles to project-related assets;
- technical status of project-related assets and/or technical solution of the project;
- factual and legal risks related to construction and/or operation of the project, including the risk of possible legal disputes and their resolution;
- political risks, including the risk of a change in legislation relevant for the project;
- expected commercial profitability of the project; and
- the financing structure of the project, including the financial stability of the investors.

The standard way to identify project risks is to carry out due diligence, which – depending on the scope and types of potential project risks – can be focused on legal, financial, technical as well as environmental issues.

While the Czech Republic is considered quite stable, in comparison with developing or other politically unstable countries (in particular, the risk of extensive nationalisation or expropriation of property in the Czech Republic is very low), there is still a risk of future changes of legislation relevant to the project. Such changes in the law may be triggered by, for eg, voters preferring a different political party or a shift in how the public feels about a particular activity.

In the Czech Republic, the preferred legal form for an SPV is a limited liability company (s.r.o.). A joint stock company (a.s.) is also used, but much less frequently. The popularity of the limited liability company derives from the fact that it combines the main advantages of "capital companies" (ie, no statutory liability/guarantee of shareholders for debts of the company) with the advantages of "personal companies" (ie, no requirements for registered capital, combined with less formal management of the company). The legal regulation of limited liability companies is less strict and more flexible than for joint stock companies.

8.6 Typical Financing Sources and Structures for Project Financings

The typical structure of financing sources used in project finance in the Czech Republic is a combination of a bank loan and own financial resources of investors. Investors provide funds to an SPV in two standard ways:

- as a contribution to the equity of the SPV; or
- as an investor's loan subordinated to the bank (senior) loan.

The latter option is usually preferred because it is much easier for investors to get money back from an SPV that was lent to it, as opposed to funds provided into equity. The ratio of financing between a bank loan and investor funds varies, depending on the type of project and level of risk. Bank loan financing tends to be proportionally higher, eg, in real estate projects, which are generally considered less risky. However, in current practice bank loans usually don't exceed 70 to 75% of total project costs.

Corporate bond issues are not a full-fledged alternative to bank loans in the Czech Republic, as the Czech bond market is mostly used by only the biggest players. That said, in recent years there has been an increase in small- and medium-sized companies making use of bond issues without a prospectus

(and mostly even without any collateral), but the volume of such issues is not big.

Newly developing financing methods, such as peer-to-peer lending or crowdfunding, have recently emerged as an alternative route for individuals and (exceptionally) small-sized companies to obtain financing. However, in project finance, they do not yet represent a true alternative to bank financing in the Czech Republic.

In export finance, Czech companies are entitled to use state-supported financing from the Czech Export Bank, which offers many types of loans and financing products to finance export and foreign investment. Such financing is usually accompanied by any of the insurance products offered by EGAP (Exportní garanční a pojišťovací společnost, a.s.) the state-owned export risk insurance company, which is able to insure types of export risks that cannot be insured by a commercial insurance company (typically political and war risks).

8.7 The Acquisition and Export of Natural Resources

Czech law sets out certain restrictions related to environmental protection (especially waste trade regulation and regulation of trade in endangered species of flora and fauna), arms control and other security laws, restrictions on the export of products qualifying for "dual use", laws restricting controlled substances and applicable sanction regulations. However, the law does not provide for general restrictions on the export or import of natural resources from or into the Czech Republic.

8.8 Environmental, Health and Safety Laws

There is no single set of environmental, health and safety laws in the Czech Republic. Rather, as a consequence of Czech membership in the European Union, the relevant provisions are found in national laws, regulations, technical directives and EU legislation.

There is no single state regulator for environmental matters. Competence for the enforcement of a particular legal provision lies with numerous authorities at both state and municipal level. Nuclear energy projects are subject to the competence of the State Office for Nuclear Safety.

PRK Partners s.r.o. attorneys at law

Jáchymova 2
Prague
Czech Republic
110 00

P / R / K
ATTORNEYS AT LAW

Tel: +420 2 21 430 111
Fax: +420 2 24 235 450
Email: prague@prkpartners.com
Web: www.prkpartners.com

9. Islamic Finance

9.1 The Development of Islamic Finance

There is currently no specific legal regulation on Islamic finance products in the Czech Republic. Thus, any existing Shari'a banking product must comply with general statutory regulations applicable to banking and finance services. While there have been some corporate financing transactions, at present there are no banks with a registered office or branch in the Czech Republic that offer Shari'a-compliant products.

9.2 Regulatory and Tax Framework

There is no specific regulatory or tax framework for the provision of Islamic finance in the Czech Republic. Accordingly, before entering into any Shari'a-compliant transaction, it is essential to carefully examine, in particular, the tax aspects and tax impacts on the parties. In line with current market trends, it would seem that no legislative change or development can be expected in Czech law in the near future.

9.3 Main Shari'a-compliant Products

Shari'a-compliant products are most frequently used in the financing of real estate transactions. Depending on the foreign investors involved, in lieu of a standard financing instrument governed by Czech law, a murabaha agreement, usually governed by English law, may be used instead.

9.4 Claims of Sukuk Holders in Insolvency or Restructuring Proceedings

As yet, there is no domestic regulatory framework or Czech case law available to test the position of sukuk holders in insolvency or restructuring proceedings.

9.5 Recent Notable Cases

There is presently no Czech case law, relevant to the banking and finance sector, available to test any conflict between Shari'a and Czech law.