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**INSIDE STORY – APRIL 2017**

**The fall of an economic colossus**

Of the about 15,000 insolvency procedures which are initiated in the Czech Republic in any given year, the overwhelming majority is actually conducted against private individuals seeking debt relief or against small entrepreneurs in the form of bankruptcy proceedings. But once in a while, a debtor comes on the stage of insolvency who can (or, in fact, has to) be saved, at least partially. It is in those ten or so cases every year that the debtor's insolvency is being resolved by imposing a restructuring, or “reorganization”.

Reorganization of debtors should only be attempted in those cases, however, in which this makes economic or social sense. Consequently, the Czech Insolvency Act provides that reorganization is a permitted option only if

1. total net turnover of the debtor for the last accounting period preceding the motion for insolvency was at least CZK 50,000,000 (i.e., approx. EUR 1,851,000);
2. the debtor employs a workforce of at least 50 people within the context of an employment relationship; or
3. at least one half of all secured creditors and at least one half of unsecured creditors (the figure being based, in both cases, on the size of creditors’ receivables) agree with the plan to reorganize the debtor.

In recent times, the reorganization procedure imposed on the mining company OKD, a.s. is probably the most important and most publicized case of reorganization on Czech soil. The core of OKD’s business operations was – in fact, still is – the mining of coal. Given the current Europe-wide policy of reducing the demand for fossil fuels, there cannot be much hope in a bright future for the debtor but the insolvency of OKD, a.s. is of enormous societal relevance, in a two-fold sense. Firstly, there is a perceived need to prevent the haphazard layoff of about 11,000 employees, in a region already hit hard by unemployment figures twice the national average. The second, no less important reason is the lack of liquid funds needed to finance the planned downsizing in production. Current estimates put the price for phasing down production (including the technological mothballing of mines) at up to CZK 20 billion (i.e., about EUR 0.74 billion).

The debtor, working with the insolvency trustee, has been trying to resolve its cash shortage by bringing in a private investor. But one needs to be careful here. Undoubtedly, any seriously interested private investor will want to earn a profit. This is made easier in particular by the projected reduction of OKD's debt burden, currently standing at approx. CZK 20bn. However, future earnings from the sale of coal (and, one assumes, from sales of a part of the debtor’s substantial asset base) must not “disappear” in the investor’s bank account. After all, a not inconsiderable part of this profit will be needed for the above-mentioned shutdown of operations and the closing of mines in accordance with environmental rules and regulations. In this area in particular, I perceive the need for consistent governmental oversight – something which is very hard to come by under the current legislative circumstances. For this reason, it is not inconceivable that the insolvency of OKD, a.s. may even require its own, tailor-made intervention by the lawmaker (for that matter, repeated discussions on the need for such special legislation were going on, on and off, as early as in 2016).

If no private investor is found, the government will have to step in. The Czech Republic has already received requests for financial assistance in connection with the phase-out of mining operations in the order of several hundred million crowns. However, any such cash infusions by the state are an extremely sensitive political affair, given that the previous ultimate beneficiary owners of today’s failing company likely cashed in up to CZK 65bn (approx. EUR 2.4bn) in dividends by sucking OKD’s assets base dry, whereas the profit of OKD, a.s. for the same time period was about half the amount. In the light of this history, a question asked by various politicians is whether the previous owners shouldn’t be extending “a helping hand” first. Claims have already been filed in court that are based on the purportedly illegitimate payout of dividends. However, with a view to how similar cases developed over time in the past, one should not expect this dispute to be resolved in the near future.

The insolvency procedure against OKD, a.s. was commenced way back on 3 May 2016. It follows from the above, though, that the end is nowhere near in sight. All one can do is to closely observe the further course of proceedings, the result of which will impact the region and likely have consequences for the rules by which the game will be played in any future insolvencies of giant business entities in Central Europe.

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