

COVID-19 - Key issues and measures in the Czech Republic

Dentons Prague Alert

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In the Czech Republic, the government has introduced strict measures to fight the outbreak and spread of the COVID-19 virus. On March 12, the government issued resolutions shutting down most cross-border transportation and declaring a state of emergency in the Czech Republic (currently until April 12 but likely to be extended). This resulted in the immediate closure of all schools, shops and shopping centers, sports facilities, cultural events and facilities (including religious and similar events), etc. The prohibition does not apply to meetings of constitutional bodies, public authorities, courts and other public or private persons (e.g. general meetings of joint stock companies) held pursuant to the law.

Businesses affected by the outbreak or by the crisis measures, should be aware of the following key legal issues and measures.

CLAIMING DAMAGES FROM THE STATE

If a business incurs damages as a direct result of the crisis measures imposed by the government, it may claim damages from the state. However, if the state proves that the harm without adopting the crisis measures would be higher than the harm caused by such measures, it would be released from liability. The claim for damages must be raised with the authority, which adopted the relevant crisis measures, without undue delay but not later than within 6 months after the affected person or entity became aware of the damage (and in any case not later than 5 years from the occurrence of the damage).

At this stage, it is advisable to try mitigating further damages due to any crisis measures, by adapting business operations to the changed conditions to the extent permitted by law, renegotiating relevant contracts, etc. More importantly, companies should gather and keep all relevant documents and information that may serve as proof of damages incurred (e.g. cancellations of orders, termination of contracts, receipts, returned goods, inventory of spoiled goods, payment documents, unrealized business plans, etc.).

STATE SUBSIDIES FOR EMPLOYERS

Currently, the government has encouraged employers to allow their employees to use home office as much as possible, limit unnecessary work, and encourage employees to take vacation and paid leave.

The government also approved the “**Antivirus**” program aimed at protecting jobs and decreasing negative consequences of the outbreak, by providing financial compensation of certain costs incurred by employers during the crisis to avoid employment terminations. In particular, the program offers a subsidy to cover fully or partly the salaries of those employees, who cannot work either due to an impediment the employer's side (due to the business being temporarily closed by the government, or unavailability of supplies, or reduction of demand for employer's products or services) or the employee (e.g., the employee being ordered to stay in quarantine or taking care of a child).

As part of the program, the following subsidies measures are currently available:

Regime A – Quarantine of employees. Salary compensation amounting to 60% of average pay shall be paid to employees and reimbursed to the employer through the subsidy.

Regime B – Employer is not able to assign work to employees due to government measures. If the employer has been ordered to close its operations due to the outbreak, employees will be paid a compensation equal to 100% of their average pay, and the employer will receive 80% of that amount from the program. This subsidy is currently applicable only to companies operating hotels, restaurants, shops, sporting facilities, etc., which the government has ordered to shut down entirely.

Regime C – Inability to assign work to a significant percentage of employees due to quarantine or care for a child. This subsidy shall be provided to employers, where a significant number of employees (at least 30% of the employees of the company, the company's establishment, or other organizational unit of the company) are unable to work due to the fact that other employees are on quarantine or caring for their child. The affected employees will be eligible for salary compensation equal to 100% of their average earnings. The employers will receive a subsidy amounting to 80% of the salary compensation paid out to the employees.

Regime D – Reduction of the availability of inputs necessary for the employer's activity. This subsidy shall be provided to employers, which have suffered a reduction of the availability of supplies necessary for their activity (raw materials, products, services) as a result of quarantine measures or of general production failures resulting from the spread of COVID-19 at the supplier, including foreign suppliers. The affected employees to whom the employers are not able to assign work as a result of such circumstances, will be paid a salary compensation equal to 80% of their average earnings. The employers will receive 50% of the salary compensation paid out to the employees, from the program.

Regime E – Reduction of demand for employer's services, articles and other products. This subsidy shall be provided to employers, which have suffered a reduction of demand for their products or services in the Czech Republic and abroad, as a result of quarantine measures or generally the COVID-19 spread. The affected employees to whom the employers are not able to assign work as a result of such circumstances will be paid a salary compensation amounting at least to 60% of their average earnings. The employers will receive 50% of the salary compensation paid out to the employees, from the program.

In addition, the government has introduced interest-free loans (of up to CZK 15 million) for small and medium entrepreneurs, whose business contracts have been delayed, suspended or cancelled as a result of the governmental measures adopted to fight the spread of coronavirus.

REAL ESTATE

The COVID-19 outbreak and subsequent crisis measures may have certain implications for both landlords and tenants on lease agreements for real estate in the Czech Republic. It is advisable to review issues relating to:

- (i) Potential material adverse change of circumstances and its impact for both contractual parties
- (ii) Possibility of premature termination of a lease agreement concluded for a definite term, and
- (iii) Conditions that may qualify as grounds for releasing the parties from the obligation to pay damages.

However, it is always necessary to review the lease agreement on a case-by-case basis to determine what was agreed between the parties in each specific case, and whether the application of non-mandatory provisions of the Czech Civil Code have been excluded or altered in some manner.

The COVID-19 situation also needs to be reviewed from an insurance perspective, in particular loss of rent and business interruption insurance, to determine whether the policies will cover the COVID-19 measures and their impact on the rent payment obligations. Parties should therefore ask their insurance brokers to provide the necessary analysis of this issue, before they take any legal steps, which could affect the pay out of the policy proceeds by the insurance company. Similarly, parties should also contact their lenders as it is common that loan agreements require an approval of the lenders for any substantial modifications of the lease agreements, such as rent abatements, etc.

COTRACTUAL MATTERS

Force majeure clause

Czech law provides for no general force majeure provision releasing parties from contract performance. The law leaves it up to the parties to agree on such provisions in their contracts. Not all contracts provide for a force majeure clause but if there is such a clause, its applicability to the COVID-19 situation must be assessed on a case-by-case basis.

Statutory hardship clause

The COVID-19 crisis may trigger the statutory hardship clause set forth in the Czech Civil Code. This provides that in case of significant change of circumstances resulting in a gross disproportion between rights and obligations of parties disadvantaging one of them, the affected party may claim renegotiation of the contract, on two conditions:

- (i) The affected party could not have anticipated or affected the change, and
- (ii) The change occurred or became known to that party after entering into the contract.

If the parties fail to agree on an amendment to the contract within a reasonable period, each party can turn to the court and request that the contract be changed to restore the balance or canceled. The court is not bound by the proposals of the parties. The court will dismiss the request if not filed within a reasonable period (which is 2 months unless proven otherwise). Importantly, this hardship provision will not apply to contracts in which the parties expressly assumed a risk of change of circumstances.

Termination of contract due to impossibility to perform

Under the Czech Civil Code, certain contract/contractual obligations terminate (in full or in part) if they cannot be performed. This will, however, only apply to some COVID-19 cases. Performance is not considered impossible if it may be provided under more difficult conditions, at higher costs, with the help of another person, or the after agreed period. The obliged party must be able to prove the impossibility to perform. Also, if a party fails to notify the other party of the impossibility to perform without undue delay after it became (or should have become) aware of it, it will have to compensate the other party for damages.

Release from liability for contractual damages

In a number of contractual breaches triggered by the COVID-19 situation, a party that breaches a contract will be released from its obligation to pay contractual damages if it can prove that it was temporarily or permanently prevented from fulfilling its contractual obligation due to an extraordinary, unforeseeable and insurmountable obstacle arising independently of its will. Nevertheless, this does not include obstacles arising from the party's personal circumstances, occurring when the party was in default and/or which the party was contractually required to overcome.

DISPUTE RESOLUTION (CIVIL AND ARBITRATION PROCEEDINGS)

Civil courts continue to operate in a limited fashion. In line with the recommendation of the Czech Ministry of Justice, judges have been asked to reconsider whether to hold court hearings that are not absolutely necessary (in particular due to statutes of limitation or other deadlines which necessitate a court decision). For the time being, most courts have cancelled court hearings scheduled for March and the beginning of April and have not been scheduling new court hearings. Physical access to the courts has been restricted (for example visits to courts to check and review court files have been limited to situations when such a review is critical and absolutely necessary). Due to the established system of electronic communication (through "data mailboxes") with courts and other governmental bodies, communication with courts (and permanent arbitration courts) remains unaffected.

The Ministry of Justice made it clear that it would not consider court delays caused by the COVID-19 outbreak and related measures as "unreasonable delays" that could give rise to disciplinary action or, theoretically, damage claims against the state alleging unreasonably long court proceedings.

The most popular Czech permanent arbitration court - the Arbitration Court attached to the Chamber of Commerce of the Czech Republic and the Agrarian Chamber of the Czech Republic - continues to operate in a limited regime. All hearings have been adjourned but the arbitration tribunals shall continue to work, while the administrative staff of the Arbitration Court will continue providing necessary support to the arbitrators so that proceedings may continue.

BANKING & FINANCE

Banks operating in the mortgages and retail banking segment are discussing within the Czech Banking Association a joint approach to ease the situation for borrowers, which are facing difficulties due to the COVID-19 outbreak. Currently, banks are considering (and some of them already implementing) a 3-month moratorium for repayment of mortgage and retail loans from private individuals (subject always to a request from each individual borrower).

Major banks are now waiting and analyzing their current portfolios, as it is not yet clear how long the restrictive measures will last and how severe their impact will be on borrowers. As a result, some deals in the term sheet or early documentation phase have been slowed down or put on hold. The general sentiment in the market is that banks will be lenient and will try to help their borrowers by rescheduling regular repayments or granting repayment holidays. Some banks have already launched special procedures to handle such requests in the SME segment. However, it cannot be expected that the banks will apply similar measures to all borrowers, as they do in the retail segment, and each request will be subject to individual assessment and discretion of the bank. The Czech National Bank has already indicated that merely postponing scheduled repayments by several months should not require the banks to classify the relevant loans.

From the legal perspective, we advise banking and finance clients to analyze financing documentation in respect of the force majeure/rebus sic stantibus/hardship/frustration of performance clauses. However, the vast majority of financing documentation is lender-friendly and borrowers will likely have limited room to avail themselves of any legal (including

contractual) protection in that respect, in the current absence of any overriding COVID-19-specific law or governmental decree.

A specific risk factor for many companies will be hedging arrangements and consequences stemming from any unexpected fluctuation of the CZK currency exchange rate. Czech companies, which are oriented mostly to exports and realize significant parts of their revenues in foreign currencies, have been entering into hedging arrangements to protect against the appreciation of the Czech crown. In the current situation, when the Czech crown has lost significant value vis-à-vis the euro and US dollar, many companies are facing margin calls and requests to provide additional cash collateral from banks. Such requirements reduce liquidity and put companies at risk.

RESTRUCTURING AND INSOLVENCY PROCEEDINGS

Insolvency courts continue to operate in a limited regime and are making their best effort to process the ongoing insolvency agenda. Due to the established system of electronic communication, communication with insolvency courts remains unaffected. However, the same as in civil proceedings, following the recommendation of the Ministry of Justice, almost all courts have issued more detailed procedural rules addressing the COVID-19 outbreak, adjourned court hearings, and stopped scheduling new hearings. Insolvency trustees continue to operate as usual, however, taking into account current restrictions to stop the spread of the COVID-19 epidemic, their actions are also limited. The Ministry of Justice announced that it would not consider delays or inaction by insolvency trustees caused by the outbreak as a breach of their professional rules of conduct, which could give rise to disciplinary action.

In parallel, the Czech Ministry of Justice has been discussing a set of measures that would ease the burden of the current difficult situation not only on private individuals but also entrepreneurs and companies in general. It is unclear at this moment what measures will be adopted and in what manner. Based on preliminary expert discussions, such measures (to apply during the declared state of emergency) could include a variety of actions including temporary suspension of the director's obligation to file for insolvency; temporary moratorium on debt enforcements; and/or a waiver of statutory deadlines for completing certain actions or filing claims with the court. We will monitor the situation and update you when more details on new measures are available.

If you have any additional inquiries, please do not hesitate to contact us.

Contacts

Michal Hink

Czech Republic Managing Partner
M +420 606 790 836
michal.hink@dentons.com



Adam Přerovský

Associate
M +420 725 004 238
adam.prerovsky@dentons.com

