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A security over book debts and other receivables under Czech law may take the form of a pledge or a security assignment. The security may be provided both by the borrower and by any other party (only the case of the borrower providing security is referred to further). As the current legislation has been in place only for a limited period, there is no significant case-law to these issues so far.

The agreement on security assignment or pledge of receivables has to be made in writing; however, no registration, filing, notification of the debtor or other perfection requirement is necessary for it to be valid.

The security may be exercised by requiring the borrower's debtor to pay directly to the bank, including in judicial proceedings or insolvency. In bankruptcy, the secured creditor is entitled to collect 70 per cent of the proceeds of the receivable. The remaining portion is equally distributed among all the borrower's creditors, including the secured ones.

Under current legislation, any security created two months before filing the bankruptcy petition or later (the hardening period) becomes void upon declaration of bankruptcy. Security over book debts is also subject to this period. Therefore conditional assignment of receivables, which becomes effective only upon default, does not work under current Czech law if the default occurs only a short time before the bankruptcy declaration. A new Insolvency Act, in force as of 1 July 2007, will remove the hardening period.

Definition of the assigned receivables

Czech law does not recognise a floating charge, although a proposed reform of the new civil code uses such a concept. Currently there is discussion of whether, to what extent and under what conditions it is possible to pledge or assign future receivables. Under prevailing opinion, it is subject to the ability of the parties to define the receivables in the security document sufficiently, ie so that each receivable may be identified on the basis of the security document. A general reference to eg 'all receivables against X' would not be sufficient.

The identification may be done either (i) by general reference to any receivables arising under a specific contract, if it already exists, or (ii) by precise identification of each receivable in the security

document, eg by the amount, invoice number and due date. The latter method may be used in case of pledge/assignment of a single receivable or receivables under framework agreements, as the details of the receivables are not completely clear from the underlying contract. Under such arrangement, the borrower (pledgor/assignor) would need to deliver a list of outstanding receivables to the bank on a regular basis.

The moment of entry into effect/execution of the pledge/assignment is important because of the hardening period in the case of bankruptcy. Should the pledge/assignment be executed or enter into effect during the hardening period, it becomes void upon the declaration of bankruptcy.

Eligibility of receivables

Receivables may be pledged/assigned subject to the following conditions:

- the underlying contract does not exclude assignment or pledge of the receivables arising thereunder; exclusion of assignment, without reference to pledge, would, under prevailing opinion, operate so as to exclude a pledge as well;
- the content of the receivable would not be modified by the change in the person of the creditor; excluded are, eg, claims for specific performance, but no monetary claims; and
- the receivable is not excluded by law from being the object of judicial enforcement; excluded are social security payments, gambling receivables, time-barred receivables (after the debtor has raised the time-limitation objection) and, in certain cases, insurance receivables (see below).

Specific classes of receivables*Bank account receivables*

Under Czech law, an amount of cash standing to the credit of a bank account represents, under prevailing opinion, a receivable of the account holder *vis-à-vis* the bank. There are also other opinions on the nature of the relationship between the account holder and the bank, but the practice follows the former view.

Such a receivable may be the object of security under a standard pledge or security assignment mentioned above, but also under a specific financial collateral arrangement, which gives a much stronger position to the creditor. The latter requires that both parties belong to eligible entities and at least one is a financial institution or a public entity.

Pledging/assigning receivables against the bank

It is not clear, whether a receivable of the borrower *vis-à-vis* the bank may be pledged or assigned in favour of the same bank. This would be relevant in the case of a bank account held with the security taker.

Such arrangement is widely used in practice, although doubts as to its validity have been expressed. An alternative solution could be achieved by way of setting off the balance of the account against the secured claim regularly; this, however, is outside the scope of this article.

Insurance receivables

According to the law, insurance receivables of the borrower may not be subject to judicial enforcement of a borrower's debts (and therefore may not be pledged or assigned) if the proceeds are supposed to be used for reconstruction or completely new construction of a building. It is not clear what meaning is to be given to the phrase 'which are supposed to'. Generally, it could cover any insurance claim related to a building if the amount claimed may or will be used for the reconstruction or new construction.

In practice, the banks do not consider this to be a problem and insist on a pledge of the insurance policies. The insurance companies usually accept such concept. An alternative solution would be to require the borrower to appoint the bank as a co-insured; however, this may not be accepted by the insurance company.

Content of a pledge/assignment

Effects vis-à-vis the debtor

The security is effective *vis-à-vis* the debtor of the receivable only after (i) the borrower (assignor/pledgor) notifies it or (ii) after the bank provides it with evidence of the security.

A common effect for pledge and security assignment of a receivable is that the debtor is obliged to pay to the bank. In the case of assignment, the debtor may offset its obligation to pay the receivable to the bank against any claim it had against the borrower at the time, including if it was not yet payable.

In practice, the debtor is often notified but requested to make any payments to the borrower, unless an event of default occurs. In such case, the effects of the security *vis-à-vis* the debtor, in particular those related to set-off, arise only after the event of default.

Any collateral for the receivable is, in the case of a security assignment, assigned to the bank simultaneously with the receivable. In the case of a pledge, if the collateral consists of property (movable or immovable), the bank acquires a sub-security interest in the collateral. For real estate, registration of the sub-security interest in the Real Estate Register is required. Shares in companies may not be the object of a sub-security interest.

Effects between the parties

The effects of a pledge or security assignment between the bank and the borrower may be governed by the contract, although there are certain provisions in the law which apply if the security document does not provide otherwise.

In the case of assignment, the law obliges the bank to notify the debtor and, if necessary, also the guarantor of the assignment and to provide the bank with any relevant documentation. Unless otherwise agreed, the assignor gives a warranty neither for the existence of the receivable nor for the solvency of the debtor.

In the case of a pledge, the pledgee is entitled to request additional security if the pledge loses its value. If the debtor pays to the pledgee, the latter is allowed to keep the collected amount for the benefit of the pledgor until the fulfilment of the secured debt. In the case of default, the pledgee is allowed to offset the received amount against the due debt.

Conclusion

Book debts and future book debts are widely used to secure bank loans in the Czech Republic, although there are certain points in the regulation which are not completely clear. As Czech law is fully applicable only if both the security and the receivable are governed by Czech law and if the borrower's debtor has the centre of its main interests in the Czech Republic, a conflicts-of-law analysis, which is beyond the scope of this article, may lead to the application of foreign law, which provides other solutions than those offered by Czech law.