



Real Estate

in 30 jurisdictions worldwide

Contributing editor: Sheri P Chromow

2013



Published by
Getting the Deal Through
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Real Estate 2013

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Real Estate 2013

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 7908 1188
Fax: +44 20 7229 6910
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First published 2007
Sixth edition 2012

ISSN 1756-7084

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

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Czech Republic

Gabriel Achour and Jakub Zámyslický

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TRANSFER OF REAL ESTATE

1 Legal system

How would you explain your jurisdiction's legal system to an investor?

The Czech Republic operates under a civil law system. Parties can seek an injunction from a Czech court on the basis that this is duly needed to establish a legal relationship or to prevent an action or damage from occurring. Although Czech courts will give priority to the written text of a contract, parol evidence remains admissible. The court will usually take into consideration indications of what the parties decided and intended, and not only what is recorded in the contract. From a formal point of view, all legal acts (especially contracts) on the transfer and acquisition of real estate in the Czech jurisdiction must be concluded in writing, and the signatures of the parties (ie, the seller and the purchaser) must be included on this same document. The official certification of these signatures is commonly required in order to verify the identities of the parties before the relevant Cadastral Authority.

2 Conveyance documentation

What are the legal requirements for documents recording conveyance?

Records of title to Czech real estate can be found in the Land Register maintained by the Cadastral Authority. This register provides a public database of relevant documentation called the Collection of Deeds, and any person may obtain copies of all available data (eg, agreements and other similar documents). For the sake of good business practice, it is presumed that the information in the Land Register is true and correct and can be relied upon by third parties, unless such persons have knowledge otherwise.

Czech law permits the existence of different owners of buildings and land on a single piece of real estate; a building's owner is not automatically the owner of any built-up or adjacent land, and vice versa.

Any changes to, or transfer of, ownership rights to Czech real estate will require the filing of an application with the relevant Cadastral Authority for registration of that transfer together with the relevant purchase agreement. The ownership title to the real estate will pass once that application has been approved; the decision will take legal effect from the filing date of the application.

Real estate transfers are subject to real estate transfer tax, which amounts to 3 per cent of the price of the property being transferred. This tax must be paid by the seller, however the purchaser of the real estate becomes the guarantor for the tax debt by operation of law. As a rule, retention of a notary public is not compulsory in real property transactions except in some specific cases. Where a notary's services are used, the maximum notarial fees should be proportionate to the transaction's value, varying between 0.05 per cent and 2 per cent of that amount. The charge for registration in the Land Register is 1,000 korunas per application.

The new Civil Code, however, effective from 1 January 2014, respects the old roman rule 'superficies solo cedit' (surface prevails over land) (see 'Update and trends').

3 Foreign investors

What other factors should a foreign investor take into account in considering an investment in your jurisdiction?

Restrictions preventing foreign persons from acquiring real estate in the Czech Republic have been cancelled, and there are no restrictions on the acquisition of real estate by foreign persons. Any person can acquire real estate in the Czech Republic now. The law is in accordance with the Czech Republic's international obligations under the 2003 EU Treaty of Accession. Prior to the accession of the Czech Republic to the European Union, the Czech Foreign Exchange Act effectively imposed very strict conditions on foreign nationals wanting to acquire real estate in the country. The Czech Republic was initially granted a five-year exemption to this rule at the time of accession to the EU.

4 Exchange control

If a non-resident invests in a property in your jurisdiction, are there exchange control issues? What about repatriation of capital?

According to EC Directive No. 88/361/EEC, which is binding in the Czech Republic, there must be free movement of capital within the EU market. The liberalisation of capital is expressly stated also in the Treaty on the Functioning of the European Union, which prohibits all restrictions on the movement of capital between member states and third countries. Nevertheless, the Czech Foreign Exchange Act continues to impose certain reporting duties on non-residents with respect to the foreign transfer of funds. Under this statute, the Czech National Bank is responsible for determining the scope, period, and manner of such reporting requirements.

In practice, foreign investors in the Czech Republic are allowed to freely transfer profits and capital throughout the European Union and to third countries, but these transfers must be declared subsequently for statistical purposes to the Czech National Bank. In addition, certain exceptions apply to transfers based primarily on Czech and EU rules surrounding taxation, prudential supervision, public policy considerations, money laundering, and financial sanctions agreed under the European Union's Common Foreign and Security Policy.

The Czech currency is freely exchangeable, and transactions inside the country can generally be made either in korunas or a recognised alternative.

5 Legal liability

What types of liability does an owner of real estate face? Is there a standard of strict liability and can there be liability to subsequent owners? What about tort liability?

The legal liability of an owner of real estate in the Czech jurisdiction is mainly governed by the Czech Civil Code and various other statutory provisions. Tort liability is not referred to commonly in this situation.

In general, owners and occupiers of real estate will not be liable for pre-acquisition events related to a property. An important exception comes from the fact that new owners accede to existing leases and other key agreements affecting the real estate.

Previous owners of the real estate may be held liable for environmental burdens and contamination or similar defects in the property. According to the Czech legislation, the seller is liable for both legal defects (eg, flaws in ownership) and factual defects (eg, environmental burdens) in the transferred property. This liability does not, however, cover any defects that were, or should have been, evident to the buyer upon inspection of the land or those defects that are apparent from the Land Register (eg, easements, mortgages).

A real estate seller can limit liability to the buyer for factual defects in the real estate by clear and full representations about its condition at the time of transfer. Buyers typically require sellers to make detailed representations about the current state of the real property, and agreements typically contain covenants confirming the sound condition of the title. The seller will then be liable to the buyer for damage caused by any misrepresentation or concealment of information in its contractual representations and warranties, or if the seller has committed fraud.

6 Protection against liability

How can owners protect themselves from liability and what types of insurance can they obtain?

Various insurance companies offer different types of insurance that can protect real estate owners against liability. Relevant policies include coverage against general damage caused through the operation of a business, with different kinds of business attracting different insurance conditions; and construction insurance, which protects against risks of all kinds during the construction process. In addition, environmental insurance has recently become slightly more popular and more widely offered in the Czech Republic mainly as a result of the general influence of EU regulations. Czech legislation on environmental harm stipulates that where companies are at increased risk of endangering the environment because of dangerous business operations, they must set aside financial reserves to address the potential impact of ensuing environmental disasters. Insurance companies have responded to this new act by establishing specific policies.

Czech insurance companies also offer standard civil liability insurance, which is popular among sellers and purchasers of real estate inside the country. (For a comprehensive summary of the potential civil liability of Czech real estate sellers and purchasers for legal and factual defects in a property, see question 5.)

7 Choice of law

How is the governing law of a transaction involving properties in two jurisdictions chosen? What are the conflict of laws rules in your jurisdiction?

Czech courts follow the rule that any issues or disputes concerning rights in rem over a property should be decided according to the law of the country where that property is situated. With respect to other rights, the Czech Republic is bound by the EC Convention on the Law Applicable to Contractual Obligations (Rome 1980), which provides parties with the option of choosing the governing

law for their contract. If the contract does not specify an applicable law, then this is said to be the law that has the closest connection to the contract.

8 Jurisdiction

Which courts have subject-matter jurisdiction over real estate disputes? Which parties must be joined to a claim before it can proceed? What is required for out-of-jurisdiction service? Must a party be qualified to do business in your jurisdiction to enforce remedies in your jurisdiction?

In the Czech Republic, all civil matters not reserved for regional courts are heard by district courts, which are generally courts of first instance. Proceedings about real estate and associated rights are generally referred to the district court in the area where the property is located. Regional courts are mainly used for appeals, but the Civil Procedure Code also stipulates that they can be first instance courts.

Parties may also have the option of resolving a dispute through arbitration proceedings as a substitute for general court hearings. This option generally must be agreed upon in the arbitration clause in the contract between the parties. Arbitration proceedings in the Czech Republic are typically heard by arbitration tribunals, consisting of three arbitrators, under the rules of Arbitration Act and own rules of specific arbitration courts.

The essential parties to Czech judicial proceedings are the plaintiff and the defendant. In certain specific cases of appeal, formal legal representation of both sides is mandatory.

Foreign parties do not have to be qualified to do business in the Czech Republic in order to enforce judgments in Czech courts. Out-of-jurisdiction service, that is, service of process directly between the parties where one is outside the Czech jurisdiction, must be made through the Ministry of Foreign Affairs.

9 Investment entities

What legal forms can investment entities take in your jurisdiction? Which entities are not required to pay tax for transactions that pass through them (pass-through entities) and what entities best shield ultimate owners from liability?

Recognised investment entities in the Czech Republic include:

- limited liability companies;
- joint stock companies; and
- general commercial partnerships, limited partnerships, and cooperatives.

In line with EU legislation, corporate entities such as European Cooperatives and Societas Europaea may be set up in the Czech Republic.

A foreign entity may also establish its local branch in the Czech Republic. Although this branch does not constitute a legal entity, it must be registered in the Czech Commercial Register. In addition, the branch is subject to the same legal, accounting and tax rules as other recognised entities.

A Czech limited liability company is the equivalent to a public limited company in the United Kingdom. As a matter of law, domestic and foreign investors in the Czech Republic must be treated identically, and they are subject to the same regulations and tax codes.

A limited liability company provides the best means to shield owners from liability, since members are jointly and severally liable only to the extent of the unpaid parts of their investment contribution; the minimum registered capital for such a company is 200,000 korunas. Parties often try to avoid real estate tax liability by transferring ownership interests (shares) in a special purpose vehicle (ie, a limited liability company) holding real estate property rather than transferring that property directly.

10 Foreign investors

What form of entities do foreign investors customarily use in your jurisdiction?

Joint stock companies and limited liability companies are the corporate forms most often used for the operation of foreign companies in the Czech Republic. There are various differences in the establishment and running of these two corporate entities. As a basic principle, however, a limited liability company provides for simpler administration than a joint stock company. A single person can be both the sole owner and executive of a limited liability company; separate limited liability companies can also be established to meet the criteria of individual projects. A joint stock company is generally more suitable for larger businesses or where numerous shareholders are involved. Creditors may also feel more comfortable providing financing to a joint stock company due to the higher paid-up capital and stricter management controls. Upon their mandatory registration in the Czech Commercial Register, foreign-owned companies become Czech corporate persons and have the same rights and duties as any other Czech corporate entity.

11 Organisational formalities

What are the organisational formalities for creating the above entities?
What requirements does your jurisdiction impose on a foreign entity?
What are the tax consequences for a foreign investor in the use of any particular type of entity, and which type is most advantageous?

According to the Czech Commercial Code, a limited liability company may have a minimum of one and a maximum of 50 founders. The company has a minimum registered capital of 200,000 korunas. At the time of foundation, the company must conclude articles of association in the form of a notarial deed, identifying the entity, its registered capital, and responsible persons. It may also issue statutes that set out the regulation of its internal affairs and various other matters. Following foundation, the company must submit an application for a trade licence, with all relevant attachments, to the Trade Licence Office. The licence should be issued within five days of the application. Within 90 days after the granting of the trade licence, the company must apply for its registration in the Czech Commercial Register. Registration is again based on an application form together with all relevant documents, including the trade licence.

A joint stock company is a capital company. Its basic registered capital must be at least 2 million korunas. As in the case of a limited liability company, the formal establishment of a joint stock company is a two-stage process, requiring incorporation and then registration in the Commercial Register.

A joint stock company may issue either registered shares or bearer shares. It is expected that these shares will be publicly traded, and they may take either certificated or uncertificated (paperless) form. Accounts of a joint stock company must be filed annually. Advantages of this entity include the confidentiality it ensures to beneficial owners, with no liability incurred by its shareholders.

12 Documentation

Is it customary in your jurisdiction to execute a form of non-binding agreement before the execution of a binding contract of sale? Will the courts in your jurisdiction enforce a non-binding agreement or will the courts confirm that a non-binding agreement is not a binding contract? Is it customary in your jurisdiction to negotiate and agree on a term sheet rather than a letter of intent? Is it customary to take the property off the market while the negotiation of a contract is ongoing?

Prior to entering into a contract of sale, it is common for parties in the Czech Republic to conclude either a non-binding letter of intent, heads of terms, a terms sheet, or a memorandum of understanding providing the basic transaction terms; such documents clearly state that they are not legally binding. Alternatively, the parties may conclude

a binding pre-sale agreement in which they undertake to enter into a purchase agreement upon the occurrence of certain circumstances. Czech courts may enforce such pre-sale and analogous pre-lease agreements. In practice, this means that where an obliged party under a pre-sale/pre-lease agreement fails to conclude the ensuing contract, the counterparty may seek a court decision replacing the signature of that obliged party; the relevant sale (lease) agreement will be deemed to be concluded on this basis.

There is no specification in law as to whether the parties must conclude a specific pre-sale agreement. Real estate agents or the parties themselves will determine whether to take a property off the market while contractual negotiations are under way.

13 Contract of sale

What are typical provisions in a contract of sale?

A Czech contract of sale must include and describe the transferred real estate, the purchase price and the identities of the contracting parties.

Typically, the purchase price is paid through an escrow agent. This means that an escrow agreement is also executed among the parties and the escrow agent. Escrow funds are usually held by banks, notaries public or attorneys. The amounts and terms of down-payments vary according to individual contracts.

Although the title to all real estate in the Czech Republic is registered in the Land Register, there is no state guarantee of the accuracy of those data. As noted above, this means that the buyer must always conduct a thorough investigation of the seller's title, taking into account any charges, covenants or other restrictions affecting the property. This will require research – at the buyer's expense – into all existing acquisition agreements, restitution claims, and other documents kept by the Cadastral Authority in the Collection of Deeds.

The buyer's costs will include the costs of its own due diligence, title insurance and legal fees. The seller must pay real estate transfer tax and its own legal costs. Unless the parties agree otherwise, a tax declaration must be filed regarding the real estate transfer and all tax settled by the end of the third month following the month in which the purchaser's ownership title was registered in the Land Register. Payment of other costs is allocated under the purchase agreement between the parties. The typical tax year runs from January to December.

14 Environmental clean-up

Who takes responsibility for a future environmental clean-up? Are clauses regarding long-term environmental liability and indemnity that survive the term of a contract common? What are typical general covenants? What remedies do the seller and buyer have for breach?

Liability for environmental clean-ups in the Czech Republic is covered by various regulations and legislation. The general conditions for civil liability under the Civil Code also cover environmental issues; on this basis, liability for environmental violations lies with the person who has contaminated soil or groundwater. The 'polluter pays' principle is also effective under Directive 2004/35/EC on environmental liability, which has been implemented into Czech law.

In the case of any direct purchase of a building or land, the seller must inform the purchaser about all environmental problems on that property. Usually this is achieved through the inclusion of representations and warranties in the relevant real estate contract. Please note, however, that this responsibility does not apply to a seller disposing of a property affected by an environmental problem if this disposal is part of a larger company merger or acquisition.

Special rules govern environmental clean-ups of properties acquired during the privatisation process. If, at the time of the transfer of such privatised property, the purchaser knew or should have known about its contamination and either the state provided guarantees of

decontamination, or the price of the property was lowered because of that contamination, then the purchaser will be liable for the resulting decontamination costs. In the event that state guarantees of decontamination prove to be unreliable, the state may, in turn, be liable to the purchaser for certain consequences of these guarantees, depending on the statute of limitations. During the privatisation of state-owned industrial zones, the state entered into agreements with purchasers of affected land areas on special conditions. These purchasers have a duty to decontaminate the land, and their expenses to this end will be partly reimbursed by the state.

15 Lease covenants and representation

What are typical representations made by sellers of property regarding existing leases? What are typical covenants made by sellers of property concerning leases between contract date and closing date? Do they cover brokerage agreements and do they survive after property sale is completed? Are estoppel certificates from tenants customarily required as a condition to the obligation of the buyer to close under a contract of sale?

When the ownership of a property changes according to Czech law, all rights and obligations pass to the new owner, including those related to the rent roll. A tenant of transferred property (excluding a tenant of non-residential premises, eg, office space, retail space) has the right to withdraw from its lease agreement immediately after the ownership change, that is, once that tenant receives formal proof of the change. The tenant can terminate the lease agreement on this basis even if the agreement was concluded with the previous owner for a definite and still valid period of time.

The property transfer contract between the seller and purchaser typically includes representations by the seller regarding the current state of the rent roll, including all relevant information and conditions connected to leases. In addition, the seller usually undertakes that it will not conclude any lease or enable any third parties to burden the property during and after the sale process.

In general, transfer agreements do not refer to brokerage agreements, which are agreed on and signed separately by relevant parties, that is, the broker(s), the seller or the purchaser. Such agreements strictly govern limited arrangements between their parties, and should have no effect on lease or other rights and obligations under the transfer contract.

16 Leases and mortgages

Is a lease generally subordinate to a mortgage pursuant to the provisions of the lease? What are the legal consequences of a lease being superior in priority to a mortgage upon foreclosure? Do lenders typically require subordination and non-disturbance agreements?

Leases and mortgages are dealt with very differently under Czech regulations. The Cadastral Authority records mortgages, but not leases, in the Land Register.

The leasing of a mortgaged property can technically be prohibited in the mortgage agreement, but this is not common in practice. If the owner of a leased property changes, the tenant may (except in cases of the lease of non-residential premises) withdraw from the relevant lease agreement immediately. In all other respects, the lease agreement will bind the new owner automatically. If a property is foreclosed, which remains rare in the Czech Republic, any attached leases will persist, unless agreed otherwise in the lease contract.

17 Delivery of security deposits

What steps are taken to ensure delivery of security deposits to a buyer? How common are security deposits under a lease? Do leases customarily have periodic rent resets?

Security deposits are usual for entry into leases in the Czech Republic. Typically they consist of a cash amount equal to one to three months'

rent that is handed over to the lessor or its agent; this deposit can be used only in connection with damage to the property caused by the lessee or in the event that the lessee defaults on its agreed payments. The security deposit is agreed upon in the lease contract, and the sum transfers with the lease contract to any new owner.

The rental amount can be adjusted periodically according to the terms of the lease agreement. Adjustments occur mainly in an upward direction, and they are often imposed annually or in a contractually stipulated period. Inflation is reflected in these variations as well as in the overall market situation.

18 Due diligence

What is the typical method of title searches and are they customary? How and to what extent may acquirers protect themselves against bad title? Does your jurisdiction provide statutory priority for recorded instruments?

Prior to the acquisition of real estate in the Czech Republic, a due diligence inspection should include:

- examination of property title in order to confirm the seller's due ownership and to establish the status of any relevant charges, covenants, or other restrictions – this will require a thorough assessment of all existing acquisition agreements, restitution claims, and other documents kept by the relevant Cadastral Authority in the Collection of Deeds;
- physical land survey – this should include the identification of any environmental hazards and assessment of property access, the legal status of relevant roads, and affected infrastructure. Detailed enquiries should be made about drainage, water supply and other utilities such as gas and electricity and tree preservation, historical preservation issues, and so on;
- environmental profile – this will entail a thorough survey of past uses of the property, any contamination risks, and likelihood of flooding, and so on;
- zoning and land use analysis – this will require a survey of the applicable regulatory framework, master plan and relevant planning permissions, occupancy permits, planning proposals, and road schemes, and so on;
- appraisal; and
- assessment of legal feasibility and advisability of the sale, including further review of all relevant leases and other contracts and confirmation of the standing and authority of the seller based on the examination of financial statements, court and bankruptcy records, and so on.

There is no market standard for pre-acquisition due diligence and pre-acquisition enquiries in the Czech jurisdiction. Investors are advised, however, to trace the chain of ownership titles and documents back at least 10 years. This involves inspecting all documents (especially purchase contracts). In certain cases, privatisation documents must also be inspected. The entire investigation process is generally time-consuming.

Performing due diligence in the Czech Republic is of utmost importance. Investors cannot afford to rely solely on entries in the Land Register that are only prima facie correct; any evidence to the contrary could override their content. Czech real estate properties are particularly vulnerable to restitution claims that are not apparent in the corresponding Land Register entry.

19 Structural and environmental reviews

Is it customary to arrange an engineering or an environmental review? What are the typical requirements of such reviews? Is it customary to get representations or an indemnity? Is environmental insurance available? Is it customary to obtain a zoning report or legal opinion?

Engineering reviews are standard, and environmental reviews are becoming more and more common. Even though the 'polluter pays'

principle will generally apply in liability disputes (see question 14), an environmental review is generally recommended before the purchase of real estate, especially in the case of the acquisition of shares in companies holding real estate. (Please note that under the ‘polluter pays’ principle, liability will rest with the special-purpose vehicle (SPV) in whose name the pollution was carried out, ie, not with the former owner of that SPV at the time of the pollution.)

Representations and indemnities concerning the sound engineering and environmental condition of a property are prevalent in sale documentation. Such undertakings are essential to ensure the liability of the seller in the case of a share deal.

Environmental insurance is becoming more and more common in the Czech Republic.

Zoning reports are freely available to the public at the Cadastral Authority. Legal analysis of these zoning reports and other acquisition issues form standard parts of the buyer’s due diligence process.

20 Review of leases

Do lawyers usually review leases or are they reviewed on the business side? What are the lease issues you point out to your clients?

As a rule, existing leases over a property will transfer to the new owner of that property. Where non-residential property is concerned, the ownership change will not be valid grounds for either party’s withdrawal from lease (unless stipulated otherwise by the parties). (In the case of residential properties, the option to immediately withdraw is given only to the tenant based on such an ownership change.) The existence of a lease on specific terms (covering, for example, the rental amount, duration, reliability of tenant, etc) can therefore be a significant factor in deciding whether to go ahead with a real estate purchase. This means the review of leases is a very important matter regularly undertaken by lawyers.

Crucial issues that lawyers will investigate regarding these leases include the validity of the lease; its term (including options to renew and break clauses); the rental amount and potential for its change/increase including indexation clauses; obligations to pay for utilities and services; rights to assign and sublet; maintenance and repair obligations; security of rent (bank guarantees, deposit); insurance obligations; and methods of termination.

Where property is transferred as part of an asset deal, contracts such as property management agreements will not bind the new owner after the sale. (Only limited contracts, ie, mortgage contracts and other rights in rem will remain binding on the purchaser in this situation). In a share deal, by contrast, all attached contracts will pass to the new owner. This includes property management agreements concluded by the seller.

21 Other agreements

What other agreements does a lawyer customarily review?

The most important agreements usually reviewed by lawyers within a due diligence investigation (besides those mentioned in question 18) are construction and design contracts; facility management agreements; all contracts establishing mortgages, other liens, or easements (irrespective of the fact that mortgages and most easements are registered in the Land Register); and loan agreements. Furthermore, planning permits and their conditions also need to be examined.

22 Closing of transaction

How does a lawyer customarily prepare for a closing?

The closing of a real estate transaction usually involves at least four steps. Prior to concluding the sales contract, it is generally required that the purchase price be deposited in the custody of a bank, notary public or independent attorney. When the contract of sales is concluded (signatures should be authenticated by a notary public or a local authority), an application should be filed immediately with

the relevant Cadastral Authority for registration of the transfer in the Land Register, together with all obligatory annexes including the sales agreement. Any party to the sales agreement can submit this application. The purchase price is paid out from custody to the seller upon the delivery of either this application with confirmation of its filing from the Cadastral Authority, or an extract from the Land Register certifying that the buyer has been duly registered as the new owner.

FINANCING

23 Form of lien

What is the method of creating and perfecting liens?

Under Czech law, a lien can be established especially over personalty, real estate, an enterprise or a receivable (eg, rental payments under a lease). Such a lien can be created and perfected by way of a written contract, the decision of a court or administrative authority or, in limited cases, *ex lege*.

If a lien is created by the ruling of a court or administrative authority, it will take effect from the date when that ruling enters into legal force. If a lien is established under a contract, it will come into force as follows:

- Any lien over real estate registered in the Land Register will take effect upon registration. Registration of the mortgage or other lien will happen following the approval of registration of the application, filed together with the relevant contract, from the Cadastral Authority. Registration takes effect from the filing date (not from the date of the approval of the registration of an application).
- A lien over personalty will require the conclusion of a written contract between the parties followed by the handover of the personalty.
- Where a pledge is made over real estate not registered in the Land Register, or over any enterprise, any set of personalties, or a single personalty that is not going to be handed over, then the pledge contract must take the form of a notarial deed. The relevant lien will be created upon its registration in a special Register of Pledges run by the Czech Notarial Chamber. The registration of the lien is done by the notary public who prepared the notarial deed.
- A lien over a receivable occurs simply through the conclusion of a written contract between the parties. No special registration is required.

24 Legal requirements

What would be the ramifications of a lender from another jurisdiction making a loan secured by collateral in your jurisdiction? What is the form of lien documents in your jurisdiction? What other issues would you note for your clients?

Under Czech law, there are no restrictions on the creation by foreign nationals of mortgages over real property inside the country. Lenders doing business inside the Czech Republic therefore attract the same fees, documentary charges and taxes as their local counterparts. As noted in question 23, any lien contract must be in writing, and in some cases, the form of a notarial deed will be necessary. The registration of a mortgage in the Land Register is subject to a minimal fee (approximately €40). Beyond this fee, however, there are no special taxes for recording mortgages.

25 Loan interest rates

How are interest rates on commercial and high-value property loans commonly set (with reference to LIBOR, central bank rates, etc)? What rate of interest is unreasonably high in your jurisdiction and what are the consequences if a loan exceeds the reasonable rate?

Generally, interest rates on commercial and high-value property loans are agreed across a range based on PRIBOR (Prague interbank offered rate). Such interest may, however, be set on the basis of any other equivalent (such as Euribor), or a fixed rate.

The impact of imposing unreasonably high interest rates will depend on whether the loan agreement was concluded under the Czech Commercial Code or Civil Code.

In the case of a loan under the Commercial Code, courts will not step in to protect a party from the imposition of interest rates higher than what would be usual under similar circumstances. Nevertheless, the borrower can demand independently that the lender apply the usual interest rate.

In contrast, where a loan is concluded under the Civil Code, an interest rate will be deemed to be void if it is considerably higher than the usual interest rate. The loan agreement will remain valid, however, notwithstanding the unreasonably high interest rate.

26 Default and enforcement

How are remedies against a debtor in default enforced in your jurisdiction? Is one action sufficient to realise all types of collateral? What is the time frame for foreclosure and in what circumstances can a lender bring a foreclosure proceeding? Are there restrictions on the types of legal actions that may be brought by lenders?

Under Czech law, remedies against debtors in default are enforceable through court proceedings. Alternatively, these claims may be resolved through arbitration, that is, through non-judicial proceedings decided by appointed arbitrators, if so agreed between the parties. The ruling of the court or arbitration tribunal will provide the formal basis for enforcement or execution of a claim. Where contracts are made in the form of a notarial deed, they may also contain a 'direct enforcement clause', providing alternative grounds for execution proceedings. These clauses allow creditors to enforce their claims without any judicial or arbitration process. Any asset of the debtor can be affected by such enforcement.

When a debtor breaches an obligation that was secured by a lien, its creditor can seek execution title (as explained above) over all of the debtor's assets. Obtaining this title can, however, be somewhat time-consuming. As an alternative, the creditor can ask the court directly for a foreclosure order and a mandatory auction of the assets being pledged. When there is a variety of collateral securing an obligation, the debtor can choose some or all of these assets to be the subject of the auction.

The rule of priority (according to the dates when liens were created) applies where there are multiple obligations secured by the same collateral.

27 Protection of collateral

What actions can a lender take to protect its collateral until it has possession of the property?

The owner of mortgaged property is obliged by operation of law not to decrease the value of the property in any way while the mortgage is effective. If this obligation is breached, then the debtor must provide the creditor with further security; otherwise the creditor's claim, which became unsecured due to the decrease in value, will mature immediately.

Usually, the creditor is not in possession of the real property that is subject to its lien. Even where the creditor has such property in its possession, it is generally prohibited by law from collecting any profit from that property (including rent), unless decided otherwise

between the parties. This prohibition applies even during the execution (foreclosure) process.

28 Recourse

May security documents provide for recourse to all of the assets of the borrower? Is recourse typically limited to the collateral and does that have significance in a bankruptcy filing? Is personal recourse to guarantors limited to actions such as bankruptcy filing, sale of the mortgaged property or additional financing encumbering the mortgaged property or ownership interests in the borrower?

Creditors can have recourse to all of a debtor's assets (ie, not only the collateral for their claim) if they obtain execution title against that debtor following a default on its obligations (see question 26). The receipt of such execution title will not, however, ensure the creditor preferential treatment in the bankruptcy proceedings.

In the bankruptcy proceedings, creditors with secured claims will take priority over unsecured creditors. Unsecured creditors generally cannot access the collateral being pledged for their claims, and they must compete for proportionate payouts from the sale of the bankrupt's assets that were not subject to any lien.

29 Cash management systems

Is it typical to require a cash management system and do lenders typically take reserves?

In the Czech Republic, cash management was not widely used. Multinational investors and international developers, however, require it. Domestic companies are using it due to financial crises and based on the advice of international financial and tax advisers. The Czech practice of a cash management system includes the collection, concentration and disbursement of cash (as in other jurisdictions). Under the Czech practice, cash management appears to be of significant importance for new businesses and projects. Cashflow is a typical problem of development companies. Firms (usually in one group) also try to concentrate the cash into one centre (account) through a cash-pooling system, to have control over their cash and to establish their investment opportunities with larger sums of surplus money.

30 Credit enhancements

What other types of credit enhancements are common? What about forms of guarantee?

The techniques and methods of credit enhancement are internal (subordination, cash collateral, excess spread, over-collateralisation) and external (provided by third parties). These depend on the type of transaction. Guarantees of completion are required namely in construction projects. This means that there is a condition in the facility agreement to require such guarantee to be given by the construction company. Proceeds from such guarantees are usually assigned or pledged in favour of the financing bank. Letters of credit are used in a number of limited transactions. In the Czech Republic retention is used rather than holdbacks. Retention means that the general contractor of a construction project invoices the owner for the portion of the work they have performed 100 per cent to date, and the owner pays, minus a retention amount of, typically, 10 per cent. Although the contractor may have completed the work, they can only be paid for 90 per cent. The retention is released after substantial completion of a project and after expiration of the warranty period. Recourse carve-back guarantees are not used. It is standard that a parent guarantee is given to secure obligations from the loan facility agreement. Banks also require a letter of comfort.

31 Loan covenants

What covenants are commonly required by the lender in loan documents? What is the difference depending on asset classes?

Typical loan covenants regulate the conditions under which the debtor may draw on the loan; the terms for repayment; the loan's purpose (usually barring the debtor from using loaned funds for any purpose besides that stated in the loan document); interest rates, related fees and costs; and general representations and warranties.

32 Financial covenants

What are typical financial covenants required by lenders?

Standard financial covenants based on loan-to-value and debt-service coverage ratios are commonly used. It is not common to require ongoing appraisals.

33 Bankruptcy

Briefly describe the bankruptcy system in your jurisdiction.

Bankruptcy proceedings commence only once a bankruptcy petition has been filed with the relevant court. A debtor is obliged to file such a petition if it is unable to fulfil its payment obligations (or it is evident that it will not be able to fulfil these obligations in the future), or if it is overburdened with debts. Should the debtor fail to meet this filing obligation, its authorised representatives will become by operation of law guarantors for any resulting damages. Any creditor may also lodge this bankruptcy petition over the debtor once the above-described conditions are met.

From the date when the bankruptcy petition is filed with the court, any substantial alteration of the debtor's assets is prohibited.

In order to be taken into consideration in the bankruptcy proceedings, all creditors' claims must be submitted in a specific (and relatively short) period of time (ie, no longer than two months from the declaration of insolvency by the court).

After deciding on a debtor's insolvency, the court will appoint an insolvency administrator to assume the position of liquidator and to arrange the sale of all assets of the debtor. Any rent from the lease of an asset will be collected by the insolvency administrator and allocated proportionately among all creditors.

Proceeds from the sale of property that was the subject of one or more liens will be distributed among the creditors holding those liens. The priority (chronological) principle will apply.

Corporate reorganisation, an alternative method of resolving insolvency, remains an exceptionally rare remedy in the Czech Republic, and the number of successful restructurings in the past year can be counted on the fingers of two hands.

Update and trends

A new Civil Code and a new act on business corporations have been enacted by the parliament of the Czech Republic and will be effective from 1 January 2014. The new Civil Code will completely redefine real estate law. The new act on business corporations will also change the existing rules. Both acts aim to simplify real estate transactions and to harmonise the Czech legal framework with modern European standards.

34 Secured assets

What are the requirements for creation and perfection of a security interest in non-real property assets? Is a 'control' agreement necessary to perfect a security interest and, if so, what is required?

A security interest in non-real property is generally created by a written contract and the subsequent handover of that property to the creditor. Under Czech law, a statutory lien arises automatically over the chattel of a tenant placed in the leased premises (ie, as security for rental payments); there is therefore no need for any further contract, 'control' agreement or other formal handover of the property for this purpose.

35 Single purpose entity (SPE)

Do lenders require that each borrower be an SPE? What are the requirements to create and maintain an SPE? Is there a concept of an independent director of SPEs and, if so, what is the purpose? If the independent director is in place to prevent a bankruptcy filing, has the concept been upheld?

Commercial real estate is typically owned by Czech limited liability companies or Czech joint stock companies. It is standard (but not an essential requirement) for an SPV to be formed for the purpose of owning and operating a real estate project. For a description of the requirements for the creation and maintenance of an SPV, see questions 9. It is also common for joint venture entities to be formed outside the Czech Republic (eg, in the Netherlands), and for such entities to be parents of the SPVs. Lenders generally require that real property securing a loan be owned by a separate entity (to increase bankruptcy remoteness). The concept of an independent director is not recognised under Czech law.



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