

VK&t

NEWSLETTER NO. 3—RECODIFICATION

Dear clients,

The subject of this newsletter is to outline to you the summary of major changes in the area of real estate letting with the emphasis on the commercial leases and residential leases as introduced by the new law. As of January 1, 2014 all lease relations will, as a rule, fall under the regime of the New Civil Code. This means that all existing lease agreements will be governed and interpreted under the NCC (with certain exceptions as described below).

We believe that our Newsletter will be useful for you and can also serve as an impulse for modifications of your existing lease contracts. As the NCC will automatically apply to all lease relations, it is advisable to duly consider with each change of your current lease (or execution of new one) the wording of the agreement and contractually modify such provisions of the NCC, which can be excluded or modified by agreement of the parties and which are unsuitable for your interest.

Ordinary or usufruct type lease?

NCC introduces new term “*pacht*” (usufruct type lease) and distinguishes between an ordinary lease and that type of lease.

Lease (*nájem*) = the right of the tenant *to use the leased property*.

Usufruct type lease (*pacht*) = leases which are entered into for the purposes of a *tenant making a profit in respect of that lease*. Difference as opposed to ordinary lease is that the tenant can also take produce and profit from the leased property. This special type of lease can be arranged in respect of material and non-material assets, which are able to generate any produce and profit, such as agricultural land, wood land, manufacturing plant, etc.

Current leases under new law

Section 3074 NCC sets the fundamental rule for real estate letting by which:

- all lease agreements will be governed by the NCC as of its effective date (i.e. as of January 1, 2014), even if established prior to such date.

The exception from the above stated rule is:

- creation of a lease and the rights and responsibilities arising at the time the original legislation was in force, i.e. till December 31, 2013, will be governed by the former legislation

- lease of movable assets and usufruct type lease (pacht), where the rule is that agreements entered into prior to January 1, 2014 will be governed by the former legislation; in case of usufruct type lease NCC particularly refers to the existing regulation of the lease of agricultural land governed by the regulation under Agricultural Land Act).

Subject of the lease and lease of non-existing real estate

The NCC expressly stipulates that *it will also be possible to lease real estate that does not exist at the time of creating of the lease* provided the real estate in question can be clearly identifiable.

Opportunity for higher protection of the tenants: If the leased real estate is registered in the public register (Cadastral Register), it will be also possible, with the owner's consent, to register the existence of the lease with the Cadastral Register.

Lease Term

Any lease agreed for a definite period of time longer than 50 years will be assumed as agreed for an *indefinite period of time*, while during the first fifty years of the lease, a notice of termination will be only possible for reasons agreed upon by the parties and within the contracted notice period. The parties may divert by agreement from the above specified rule, however, pursuant to Section 2000 NCC, in cases when a lease has been agreed without any serious reasons for a definite period

of time exceeding 10 years (or binding the parties for lifetime) and provided such lease had already lasted over 10 years, the parties may turn to court with proposal for judicial review and termination of the lease.

Fundamental changes on the side of the landlord:

- Obligation to hand over the real estate to the tenant on the date agreed under the lease agreement otherwise upon invitation of the tenant.
- Carry out the ordinary maintenance if agreed with the tenant.
- Obligation not to change the lease item “at its own discretion” (without an agreement with the tenant).
- Right to distress tenant’s belongings from the leased property in case of overdue rent.
- Provided the tenant uses the real estate after the elapse of the of the lease term, the NCC creates an obligation of the landlord to invite the tenant to return the property (it is not necessary to initiate legal proceeding for vacating of the real estate in order to prevent the renewal of the lease).
- *If the owner transfers the title to leased real estate, the new owner will not be bound by the arrangements in respect of the landlord’s obligations that are not stipulated by law. An exemption to this only applies if the new owner was aware of the arrangements stipulating the landlord’s obligations that existed and that were beyond the scope of law. Therefore we highly recommend, when transferring the title to leased real estate, also submit to the new owner copies of all existing lease agreements.*

Fundamental changes on the side of the tenant:

- Obligation to allow the landlord to inspect the leased item upon his notification. Provided such inspection brings “significant burdens” for the tenant, he shall be entitled to rent deduction.
- Defect in the lease item preventing the tenant from the actual use of the property, allows the tenant to demand remission of the rent or terminate the lease with immediate effect.

Lease Termination

Change in the ownership title:

- Change in the ownership title does not constitute a ground for lease termination.
- Right to terminate the lease due to change in ownership title can be contractually agreed, save for residential leases of apartments when such possibility is not allowed. Even if there was no reason for the new owner to doubt that the new owner bought an item unencumbered by any lease, the new owner is entitled to give notice of termination of an existing lease within three months from the date when the new owner became aware, or ought to have become aware, that the real estate was leased and who was the tenant.

Lease agreed for definite term can be terminated by notice only if the lease agreements provides for termination reasons and notice period.

Lease agreed for indefinite term can be terminated by notice without any given reasons. The notice period for immovable property is three months; one month for movable assets.

In cases stipulated by the law the *lease can be terminated with immediate effect* (impossibility to actually use the leased property, serious danger caused by default provided the tenant used the property in breach with the lease agreement, extensive damage caused to the party as a result of gross breach of the contract terms by the other party, etc. *Obligation to support the termination with proper explanation in case of immediate notice.*

The above applies, as a rule, to general leases; specific terms apply to the individual type of leases. For limitations concerning lease term see above (lease term).

The NCC repeals and replaces the existing regulation of the Act. No. 116/1990 Coll., the Act on the Lease and Sublease of Non-Residential Premises. The NCC also abolishes the actual legal definition of the term of “non-residential premises” as the decisive criteria for assigning the lease to the specific regulation. The specific regulation can be found in the NCC under Section Lease Rights, sub-section 3 “Special provisions concerning the lease of premises used for business” (Section 2302–2315 NCC). Issues not governed by special legislation will be governed by general legislation applicable to a lease (sometimes even to residential lease).

Changes introduced by the special provisions of NCC for the lease of premises used for business:

- **Subject of the lease**
 - the purpose of the use of the premises (pursuit of a business activities) is set as primary criteria, not the actual classification of the type of the real estate as “non-residential”;
 - in case of lease of an area or room, which “is mainly used for pursuit of a business activities” it is not even necessary in the lease agreement to expressly assign the regime of the lease to the specific regulation of sub-section 3 of the NCC or even to expressly state the purposes of the lease (however, in practice, we still recommend to include in the lease agreement precised definition of the purpose of the relevant lease).
- **Change of tenant in case of transfer of the lease**
 - the NCC puts in place the principle of the tenant right to transfer the lease in relation

- to the transfer of its business activities;
- subject to prior written approval of the landlord and written form of the agreement on the transfer of the lease.
- Right of the tenant, with the consent of the landlord, to place at the leased business premises adequate signage/corporate logos, etc. *Provided the landlord does not express his opinion to the tenant within one month from notification, the consent is deemed as granted.*
- **Termination**
 - lease for definite term: NCC narrows and generalizes the reasons for lease termination by landlord—*first reason* demolition or reconstruction of the real estate, which prevents the tenant from the use of the leased premises and *second reason* gross breach of obligations against the landlord (NCC specifies two examples of such breach—placement of the corporate signage at the premises against the disapproval of the landlord and default on rent and utilities payment exceeding one month). *Termination notice must specify the termination reason otherwise invalid;*
 - lease for indefinite term: right to terminate the lease without any given reason with six month notice period; in case of “serious reasons” possible notice period three months (however in case the duration of the lease already lasted 5 years and the other party could not expect the lease termination, the notice period must be the minimum of six months).

- The NCC puts in place the principle of objection to a notice of termination when the party whose relationship is being terminated will be entitled, within one month from receiving the notice of termination, to challenge the notice of termination with the terminating party, and this will be the precondition of the creation of the right to challenge the notice of termination with a court.
- Provided the tenant will vacate the property in compliance with the termination notice, it is presumed that he accepts the termination notice without any reservations.
- The NCC introduces new principle of *compensation from the landlord or the new tenant for acquiring a customer base*. If the lease ceases to exist by reason of the landlord's notice of termination for a reason other than gross breach of the tenant's obligations, the tenant will be entitled to compensation for the benefit of the landlord, or of the new tenant, that they have gained by taking over the customer base built up by the original tenant.

Impact of NCC onto existing commercial lease agreement:

- **As of January 1, 2014 general or special lease**
 - Pursuant to Section 3074 NCC all leases (existing lease agreements) will be governed by the NCC as of its effective date. In combination with the criteria that the purpose of the use of the premises (pursuit of a business activities) is set as primary, this will have two possible effects on the existing leases:

- (1) Lease/sublease agreed for the purposes of “pursuit of a business activities,” will be governed by Section 2302–2315 NCC (in practice this will apply to most of the existing lease/sublease agreements); but
- (2) Lease/sublease for which the purposes of “pursuit of a business activities” had not been agreed, typically pursuit of non-profitable activities in the civil sector entities, such existing lease/sublease agreements will be governed by the NCC’s lease general terms (including terms for termination of such leases).
- **Change (limitation) in termination reasons on the side of landlord**
 - Provided the lease agreement will refer to statutory provisions concerning the termination reasons for the lease, the landlord will have only general and narrow reasons for termination in case of definite term lease—see above.

New level of housing protection rules

The NCC will newly provide housing protection rules also to a house as a whole, provided the lease agreements is entered into for the purposes of meeting the lessee's housing needs. As of January 1, 2014 the lease of house will have the same degree of protection as any lease of flat. The NCC has special provisions for such type of lease relation in its Sub-section 2 "Special provisions on lease of flats and houses" (Section 2235–2301 NCC). Any reference to a flat hereunder, refers also to a house as a whole.

Break of the housing protection rule

Higher degree of protection for housing as opposed to other types of leases is expressed by the NCC in number of its provisions:

- arrangements curtailing tenants' rights under the relevant Section of the NCC shall be disregarded (Section 2235 NCC);
- the NCC does not allow any clearly disproportionate obligations imposed on the tenant and arrangements on the tenant's obligation to pay a contractual penalty (Section 2239 NCC);
- the landlord is not entitled to object the validity of the lease agreement due to absence of the mandatory form (Section 2237 NCC; the NCC requires a written form of an agreement on the lease entered into for the purposes of meeting the tenant's housing needs);

- the tenant will be granted the protection despite the fact that the leased dwelling is not intended for housing purposes;
- possibility of “lease prescription:” if the tenant has been using the leased dwelling for three years, and in good faith, the lease agreement will be deemed to have been duly concluded.

However, the housing protection rule breaks in cases the “flat or the house is leased to the tenant for recreation purposes or for other obvious short-term reasons.” The provisions of Sub-section 2 of the NCC “Special provisions on lease of flats and houses” will then not apply.

Rent may be increased against the will of the tenant, subject to statutory conditions:

- *No need to agree on rent.* Unless the agreement specifies the amount and due date of the rent, the tenant will have to pay the rent usual for similar leased real property as applicable at the time of entering into the lease agreement. If the rent cannot be assessed according to the above rule, the amount of rent will be decided by court (Section 1792 NCC).
- In the event that the rent indexation is not agreed but is not explicitly ruled out either, the NCC provides a procedure, whereby, on an annual basis, the lessor may seek a rent increase *while the landlord may seek a rent decrease to the rent* (limit for the maximum change in the rent is set at 20 % of the rent in 3 years) level usual in the location concerned.
- However, if the tenant notifies the landlord within two months period of his refusal to accept the increase allowed by law (or refuses to pay the increase rent as of the third

months from the notification), the landlord may apply to a court to decide on the new level of the rent. The same will apply accordingly in case of application of the tenant for rent decrease.

- The landlord may agree with the tenants on a rent increase by up to 10 % of the reasonably spent costs a year for improvements of the housing quality of the tenants or modifications for permanent energy and water savings. Provided at least two thirds of all tenants in the relevant building agree with such increase, the increase will apply to all tenants in the building.

Other payments and security deposit:

- The parties may contractually agree which services related to the lease are organised for and ensured by the landlord. In the absence of such contractual arrangements Section 2247 of the NCC specifies what type of services shall be organised for and ensured by the landlord throughout the term of the lease.
- *Security deposit may be agreed in the maximum amount of six times the payable rent* in order to secure due payment of the rent or the performance of other obligations under the lease. Unused part of the security deposit must be returned to the tenant after the termination of the lease together with a statutory interest.

Certain rights and obligations of the landlord:

- **Maintain the house in order**
 - Obligation of the landlord to maintain the (residential) building “in required order common to local standards.”
- **Modifications and reconstruction by the landlord**
 - Obligation of the landlord to obtain approval of the tenant with any modifications and reconstruction of the dwelling, unless these do not lower the value of the dwelling and can be carried out without any unreasonable limitations to the comfort of the tenant or if these are carried out due to public authority order or in order to prevent occurrence of extensive damage.
 - In case no approval of the landlord for modifications or/and reconstruction of the dwelling is required, the landlord is authorised to commence with such actions only after it undertakes to provide the tenant with reasonable compensation of costs incurred by the tenant in relation to vacating of the property and providing reasonable deposit for such costs. The NCC furthermore puts down the rules for notifications on the commencement of modification and reconstruction works. Provided the tenant will not confirm to the landlord that he will vacate the property within ten-day period after the receipt of the notifications from the landlord, it is deemed that tenant rejected the invite of the landlord to vacate the property. *The landlord is authorised to file an application to court for vacating of the premises within ten-day period from the rejection of its notice.*

- **Limiting the number of the members of the household of the tenant:**
 - The landlord may reserve its right in the lease agreement to provide his consent with the acceptance of new member of the tenant's household. This shall not apply to close persons of the tenant or in case of other case of major consideration.
 - The landlord may limit the number of members of the tenant's household to such number, which is adequate for maintaining conformable and hygienic conditions in the household for all members.

Certain rights and obligations of the tenant:

- **Procurement of business activities**
 - The tenant is authorised to use the dwelling for the procurement of his business activities only if it does not constitute large burden to the property.
- **Apartment maintenance**
 - The tenant shall procure for and bear the costs of general maintenance and repair of the property.
- **Modifications and reconstruction by tenant**
 - Cannot be carried out without the consent of the landlord. If necessary due to health condition of the tenant or other member of his household, the tenant can seek the court to substitute for landlord's approval if the landlord's withholds such consent without a justifiable reason.

- In case the tenant carries out any modifications *without the consent of the landlord*, he shall not be entitled to any compensation even if the value of the property increases. On the other hand the landlord may demand from the tenant the compensation equalling to the decrease of the value of the property caused by the unauthorised modifications of the tenant.
- **Long-term absence**
 - In case of long-term absence (exceeding 2 months) the tenant shall inform the landlord and appoint his representative who will be able to allow access to the property in case of necessary events (if the tenants does not appoint any representative, the landlord shall be considered as the authorised party). Provide the tenant will fail to do so and in case of serious damage to the property, the tenant will be deemed as breaching his duties in serous manner.
- **Other members of the household**
 - Right of the tenant to share his household with any third party, subject to notification of the landlord about new member, within two-month period.

Sublease

- Parties may contractually agree on ban to sublease.
- Provided the lease agreement does not forbids to do so, *the tenant will be allowed to sublease real estate property without the consent of the landlord*, subject to having

a permanent residence in the leased property, otherwise only with the express written consent of the landlord.

- Consent is deemed to be given if the landlord does not answer the tenant's request for consent within one month period (the above will not apply if the lease agreement forbids the subleasing without consent of the landlord).

Transfer of lease in case of death of the tenant

- In case of common lease, the lease shall pass to the member of the tenant's household, who was living in the leased property together with the deceased tenant, and does not owe any other residential property, but *only with the consent of the landlord provided such person is not one of the following close relatives*: husband, partner, parent, sibling, son/daughter in law, grandchild.
- The lease will then terminate within two years of its transfer. This shall not apply if the new tenant is 70 or older and/or 18 (in such case the lease shall terminate when such persons reaches 20 years of age, unless agreed otherwise with landlord).
- The person to whom the lease shall pass, is authorised to notify the landlord in writing within one-month period from the death of the tenant of his intention not to carry on in the lease. The lease shall terminate upon the receipt of such notification by the landlord.
- Provided the lease will pass to a member of the tenant's household, the landlord is authorised to demand for such new tenant the provision of security deposit if such had not been provided by the deceased party. The same right of the landlord applies also in

case he is obliged to settle the return of the security deposit with the heirs of the deceased tenant.

- Persons, who shared the household with the tenant at the time of his death, shall be bound jointly and severally with the heirs of the tenant *for all of the tenant's debts from the lease*.

No need for court authorisation of the termination notice and no housing compensations

Under the NCC a court will no longer need to authorise any reason of the landlord to give notice of termination of the lease and the landlord no longer provides for housing compensation.

Lease termination by landlord

With respect to the length of the notice period, we can divide the termination by the landlord into following categories:

- **Without notice period (immediate termination)**
 - if the tenant breaches its obligation in a particularly serious manner (such as by failing to pay the rent and the costs of services for at least 3 months or using the leased property for other than agreed purposes);
 - prior to giving the termination notice, the landlord must provide the tenant with reasonable remedy period;
 - the landlord must specify in the termination notice the reasons considered by the landlord as breach of obligation in a particularly serious manner.

- **With two months' notice period**
 - by notice without any reasons with a two-month notice period and within three months after becoming aware of the tenant's death and of the fact that the lease has not passed to members of the lessee's household and becoming aware of the tenant's heir or administrator of the inheritance (provided no tenant's heir will be identified within 6 months from the death of the tenant, the landlord may vacate the property and the lease will be deemed to be terminated).
- **With three months' notice period**
 - applicable to both definite and indefinite period leases;
 - *the NCC newly includes demonstrative list of termination reasons* (reasons specified in Section 2288 and/or for "other particularly serious reason to terminate the lease"). Section 2288(2) allows for termination also if the dwelling shall be used by one of the spouses, who is intending to leave the common household and the divorce action had been already filled; or if he needs the dwelling for the needs of his relative or spouses' relatives. The landlord must then use the dwelling within one-month period from the notice in compliance with the termination reasons specified in the notice of termination, otherwise he shall be liable for any damages caused to the original tenant and the dwelling could be re-leased to the original tenant.
 - The termination notice must specify the termination reason.
 - The landlord is obliged to inform the tenant of its right to apply to a court for reviewing

the justifiability of the notice of termination within two months from the date when it received the notice of termination.

Lease termination by tenant:

- The tenant is newly authorised to give termination notice of a *lease agreed for definite period* due to reasons specified in Section 2287, i.e. “in the event of a change in the circumstances relevant to the parties when they were entering into the agreement to the extent that the tenant cannot be reasonably required to continue the lease.”
- The tenant’s heir may terminate the lease by notice with a two-month notice period and within three months after becoming aware of the tenant’s death and of the fact that the lease has not passed to members of the tenants’ household, in any event no later than six months from the tenant’s death. This right of termination is also vested to the administrator of the inheritance.

We believe that the above summary will allow you better orientation in the new law. We are available for all your requests for any additional information.

Our newsletters are prepared in order to provide general guidance on relevant matter and cannot be considered as exhaustive professional advice. We are not able and cannot address any specific circumstances or needs in this newsletter. We do not recommend acting upon the information contained therein without obtaining independent professional advice first which we will be glad to provide at your request. No representation or warranty is given as to the accuracy or completeness of the information contained in this publication.