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Violation of the executive's obligation to act with due care in the light of the new case law of the Supreme Court of the Czech Republic

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- **On 18th September 2019 the Czech Supreme Court issued an important decision** (*case No. 27 Cdo 844/2018*), addressing the issue of the violation of the obligation of the statutory body to act with the care of a diligent manager. In this particular case, the appointed director in question did not supervise sufficiently the activities of other executive director of the company, which led to the embezzlement of the company's assets and damage to the company.
- The Supreme Court came to the following conclusion:
 - **If the executive is acting only formally** (i.e. the executive does not actually perform his function or any of the duties of the statutory body and all of those are left to the other executive, respectively to the company's employees, without any further controlling measures as to the management and administration of the company), it must be concluded, as a general rule, that **such executive is not acting with the care of a diligent manager** and as a result he **is liable for the damage caused to the company, jointly and severally with the other executive(s)**.
- It is also irrelevant that he was actually the manager who discovered the fraudulent actions of the other executive director in the office and who lodged the relevant complaint. The Supreme Court criticized the executive director for **allowing the fraudulent actions** to happen **at all** by not participat-

ing in the management of the company in any way and for the lack of controlling measures that would sufficiently prevent the criminal activity of the other executive; further on, it also criticized the executive director for not being able to detect the fraud immediately after the other executive started to withdraw money from the company's bank account and used it for his own needs.

- The Supreme Court also rejected the manager's justification that he does not have qualification to understand the **bookkeeping** and therefore he recruited qualified staff. According to the Supreme Court, it was not necessary to have accounting qualification to prevent the crime, but **the executive's minimum interest in the company's management and administration would be sufficient**, as the withdrawals of the financial means done by the other executive could have been ascertained simply by looking at the company bank statements or via internet banking.
- Also the fact that the financial statements were approved by the sole member of the company was found irrelevant. **Approval of the financial statements by the General Meeting (or the sole member in its competence) has no relevance in assessing whether the executive director breached his duties when performing his office and whether he is liable for the caused damages.**
- Finally, to the executive's objection that despite control only some of the damages may have been prevented (because any control takes place subsequently and does not prevent the damage caused

prior to the inspection), the Supreme Court reiterated that if **appropriate control mechanisms** were set up in the company, the wrongful acting of the other executive may not have occurred at all.

- Although the abovementioned decision of the Supreme Court applies to a case governed by the previous statutory regulation (*i.e. the Act No. 513/1991 Coll., Commercial Code*), valid until 31st December 2013, **its conclusions may be undoubtedly also applied to any cases arising after 1st January 2014** under the Business Corporation Act and the Civil Code.

We hope the above summary will ease your orientation in the new legislation. We are available for any of your additional requests or information or legal assistance in this area.

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