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NEWSLETTER NO. 5 – RECODIFICATION

Dear clients,

The subject of this newsletter is to outline to you the summary of major changes affecting joint stock companies introduced by two new laws—the Act on Business Corporations (Act. No. 90/2012 Coll.) (the “BCA”) and the new Civil Code (Act. No. 89/2012 Coll.) (the “NCC”). Our aim is to provide you with a description of the immediate impact of the new law on existing companies and also provide you with a summary of the most important changes for joint stock companies (the “JSC”).

- **What will be governed by new law**—new law (BCA and NCC) will apply to all rights and obligations originating as of January 1, 2014—this means that any company founded after January 1, 2014 will be fully governed by the BCA and NCC.
- **Impact of the BCA and NCC to existing JSC—existing Articles of Associations do not cease to exist, nor do they become invalid; however as of January 1, 2014 any of their provisions that are in breach of the mandatory provisions of the BCA are automatically annulled**—in general this will apply to provisions that are in breach of good morals, public order or civil rights; the law unfortunately fails to provide a specific list of such provisions and therefore it will depend on future interpretation of such general provisions of the new law.
- **Until June 30, 2014 all companies are given a period to adapt the provisions of their Articles of Associations to the provisions of the BCA** and to deposit these with the collection of deeds of the Commercial Register. This will include, inter alia, the obligation of the “old” companies to add to their Articles new mandatory provisions prescribed by the new law and also, for example, to increase their registered capital to the minimum amount of CZK 2 million. In case of default, the Commercial Register may set a remedy period and if no remedy is ensured for during that period, the court may proceed with involuntary liquidation of the company.
- **Even after January 1, 2014 the following provisions of the Commercial Code will remain as part of the Articles of the existing companies:** (i) provisions governing rights and obligations of the shareholders and (ii) provisions that are not in breach with the mandatory provisions of the BCA and the application of which had not been dis-applied by

the shareholders in the Articles.

- **By January 1, 2016 at the latest, all companies that are governed by the “combination of old and new law” may opt for the BCA as a whole and change their Articles.** This opt-in must be registered in the Commercial Register. The professional public is not united in the opinion whether or not it will be also possible to opt-in for the BCA after January 1, 2016. Companies that will not make that decision by the above set date will still be regulated by the provisions of the existing Commercial Code (where it governs the rights and obligations of the shareholders, and is not in breach with the mandatory provisions of the BCA and the application of the relevant provisions of the Commercial Code had not been dis-applied by the shareholders in the Articles). Due to the expected ambiguity related to the interpretation of the mandatory nature of the BCA provisions, the BCA general opt-in seems a favourable choice, bringing also a greater part of legal confidence.

## Time periods

- All time periods commencing prior to December 31, 2013, as well as time periods for exercising any rights according to existing legislation, will be governed by the previous law.
- Any procedures initiated on the basis of a legal act carried out prior to December 31, 2013 and leading to a decision of a corporate body will be completed under the previous law (by way of example—invitation to General Meeting sent out prior to the end of the year 2013, while the actual General Meeting will be held after January 1, 2014, in this case the regime of the General Meeting (including any of its decisions) will still be governed by the regulation of the existing Commercial Code).

**Articles of Association must comply with the new law**—by no later than June 30, 2014, each JSC is obliged to adapt its Articles of Association to the new legislation and to deliver them to the court maintaining the Commercial Register; provisions that contravene mandatory provisions of the BCA will be invalid as of January 1, 2014. The extent of the adaptation will depend on the individual JSC; the following areas should be considered:

- Different types of shares—specification of their type and description of rights that relate to such shares (the BCA no longer exhaustively lists the individual types of shares; such specification will now depend on the decision of the company);
- Specification of number of votes attached to shares of different nominal value and furthermore the total number of votes in the company;
- Information which system of internal structure (see below) had been opted for by the company and rules for setting up number of members of the Board of Directors and Supervisory Board;
- Rules for convocation of the Administrative Board, when applicable, depending on the internal structure of the company.

**Facultative provisions of Articles of Associations**—a JSC may newly decide to regulate a number of different areas in its Articles of Associations. This will depend on the individual need of each company, but the following areas may be practical for consideration (without their explicit regulation in the Articles of Association, the regulation of BCA in the specific area cannot be applied):

- Possibility to issue interim certificates for unpaid shares;
- In-kind payments of dividends;
- Possibility to provide financial assistance;
- Time and content limitation of the shareholder's request for explanation at the General Meeting;
- Time limitation of the shareholder's proposal presentation at the General Meeting;
- Use of technical equipment for voting at the General Meeting;
- Other than statutory method of circulation of the invitation to the General Meeting;
- Possibility to hold a General Meeting without meeting all of the statutory requirements for its convocation, with the consent of all shareholders;
- Possibility to vote per rollam (distant vote), not only for General Meeting and but also for other corporate bodies;
- Prolongation of office term of the corporate bodies of the JSC (under BCA the office term of Board of Directors is 1 year and Supervisory Board 3 years);
- Possibility to co-opt for missing members of the Board of Directors or Supervisory Board by the relevant body.

**Rigid form of power of attorney**—power of attorney *requires mandatory form of notarial record for acts that must be executed in the form of notarial record*: this will apply to foundation of company and decisions of sole shareholders (for which the law requires form of notarial record); concerning General Meeting, most probably the requirement of power of attorney in the form of notarial record will not apply, however this is to be confirmed by decisive practice. Practical problems may arise in particular with respect to foreign powers of attorneys, which must be executed in the form of notarial record (where such form exists in the relevant country) or must be granted with the notary in the Czech Republic.

There are already different opinions with respect to powers of attorneys executed by a foreign notary; some of these opinions state that this will not comply with the statutory provisions and the only possibility is to grant the power of attorney with a Czech notary. Interpretations of this provision, including the possibility to waive the right for the prescribed form of the power of attorney, are different; one opinion states that the non-observance of the prescribed form would cause relative invalidity (which does not apply automatically), but other opinion states that this would lead to absolute invalidity. For all these reasons it is advisable, at least until decisive practice is established, to follow the conservative approach and to organise for the power of attorney in the form of notarial record when relevant. The Czech Bar of Notaries is currently working on a list of countries that have an institute corresponding to the Czech notary (powers of attorneys executed

by these countries should be accepted) and a list of countries that do not recognize the institute of a notary (from these countries power of attorney with verified signatures will most probably be accepted).

**Authorisation of a member of a collective body to act**—the situation when the company is to be represented by an individual member of the collective statutory body (for example two members of the Board of Directors act on behalf of the company, but in specific matter only one member is to act) must be addressed *not by a power of attorney granted to the individual member by the company, but by the decision of the respective collective body, on the basis of which its individual member will be authorised to act*. Likewise in today's practice, the limitation by which "authorisation" on the basis of decision of collective statutory body cannot be general, but only for specific action, will apply.

## **End to anonymous shares**

- *JSC were obliged to change by the end of 2013 all certified bearer shares (so called anonymous shares), by one of the following methods:*
  - Change their form to book registered shares;
  - Their immobilization (i.e. physical deposition with the bank);
  - Change from certified bearer shares to certified registered shares;
- *Provided the company will fail to exercise one of the above said methods, as of January 1, 2014 all certified bearer shares have automatically changed to certified registered shares;*

pursuant to the Act on regulation of anonymous shares (Act No. 134/2013):

- certified bearer shares (so called anonymous shares) will be automatically changed into certified registered shares and also the Articles of Associations of the relevant JSC will automatically change, without need to change the registration of the company in the Commercial Register; and
- the Board of Directors of the JSC must adapt the Articles of Associations to comply with this change and submit application for the registration of the change with the Commercial Register no later than on June 30, 2014.
- Hence shareholders will be obliged to submit their existing shares for replacement by no later than June 30, 2014, otherwise they will not be able to exercise the rights attached to their shares during the delay.
- As of January 1, 2014 the companies may no longer issue certified bearer shares, only bearer shares in book form registered with the Central Depository of Certificates or certified bearer shares as immobilized certificates deposited in the bank escrow will be allowed.

## **End of office term of the members of the Supervisory Board elected by the employees**

As the BCA does not prescribe for mandatory election of some of the members of the Supervisory Board in JSC with more than 50 employees by the employees of the company, i.e. the BCA does not recognise this possibility for the election of the members of the Supervisory Board, there are some professional opinions according to which the office term of the members of the Supervisory Board elected by the employees of the company may terminate automatically as of January 1, 2014. Due

to the absence of a unified interpretation of this question and logical absence of relevant judicature, it is possible to remedy the legal uncertainty by amendment of Articles of Associations by which the election of the members of the Supervisory Board by the employees will be excluded, the existing members of the Supervisory Board recalled and re-electing the required number of members of the Supervisory Board either by the existing members originally elected by the employees or by any other candidates.

## **Website as mandatory obligation**

As of January 1, 2014 all JSC must have their own website on which they will publish information that must be shown on their business documents (such as information about the amount of the registered capital, business name, registered seat, ID no., Commercial Register identification details) together with other information prescribed by law (such as invitation to General Meeting, holding structure, expert evaluation (if mandatory)). Breach of this obligation may lead to penalization by the Commercial Register court up to the amount of CZK 100,000.

## **General Meeting**

- No longer divided into ordinary and extraordinary General Meeting;
- **Invitation**—mandatory publishing of the invitation at the website of the JSC + circulating of the invitation to the holders of the certified registered shares to their mailing address (Articles of Association may allow for different suitable method of circulation of the invitation);

- **Increased requirements on the content of the invitation**—inter alia, the invitation must include the proposed wording of the actual decision of the General Meeting, together with its explanation or the statement of the statutory body to the proposed matters of the agenda, furthermore the invitation should also list the names of the candidates of the corporate bodies proposed for election;
- **Liberalization of requirements for appointments of bodies of the General Meeting**—the BCA allows for one person to be appointed as the chairman of the General Meeting and the verifier of the minutes; the chairman of the General Meeting may also be the counter of the votes;
- **Shareholder's objection to the decision of the General Meeting**—if not recorded in the minutes of the General Meeting, a shareholder may not claim the invalidity of a decision of the General Meeting.

Below follows selection of other major changes relating to the operation of JSC under new law. These changes have become effective on January 1, 2014 and will be applicable to both new companies (incorporated after January 1, 2014) and existing companies—in some cases transitional period will apply to existing companies (by way of example amendment of the Articles in order to comply with new law must be procured for till June 30, 2014), the new law will, however, apply in most cases as of January 1, 2014 (such as intra group transactions, rules for convocation of General Meeting/publishing of invitation, conflict of interest rules, etc.).

## **Foundation**

Foundation of the JSC by approval of Articles of Association; no need for a separate foundation deed.

## **Administration of contributions**

In addition to the founders and the bank, any other person with the assumption of professional capacity to administer capital contributions (such as an advocate or notary) may be appointed as contribution administrator. Upon the foundation of the company the administrator exercises his activities on the basis of a written agreement entered into between the administrator and all of the founders.

## **In-kind contributions / appointment of expert by the company**

- The value of in-kind contributions is still to be assessed by a professional expert, while the

expert will be appointed by the founders (upon the foundation of the company) or the members of statutory body (in other cases), not the court. In-kind contribution no longer needs to be usable in relation to the subject of the business activities of the company.

- The company will from now on appoint experts in matters that by law require expert opinion; there is no longer need to have the expert appointed by court. The expert must still be selected from among the registered experts and must be independent from the company.

### **Profit share**

- To be divided among shareholders, but the Articles of Association may also designate other persons entitled to profit share.
- Determined according to the ratio of the shareholder's share to the registered capital of the company, but the Articles of Association may provide otherwise.
- Profit share is to be paid out in money, but the Articles of Association may also allow for in-kind profit share.
- Two-phase decision on profit distribution: (a) profit share is determined on the basis of financial statement approved by the supreme body of the company (General Meeting); and (b) decision of the statutory body on the payout of the relevant profit share.
- The company may newly pay out profit share deposit payments (advance payment), subject to interim financial statement and provided it will not lead to bankruptcy of the company; the maximum possible amount of the profit share deposit payment must comply with statutory limitations.

- Decision of the General Meeting on profit distribution is not required for shares with fixed profit share—simple approval of financial statement is sufficient.
- Although the BCA does not include an explicit requirement to decide on profit distribution on the basis of the relevant financial statement within 6 months from the date it had been issued (as ruled out by the Highest Court in relation to the existing Commercial Code), there are some expert's opinions according to which this rule will also apply to profit distribution under the BCA.

### **Acting of members of corporate bodies, liability**

- **The BCA keeps the obligation to act with care of diligent manager + business judgement rule**, which provides for protection of the members of statutory bodies provided their decisions and actions are: (a) legitimate, (b) carried out in good faith, (c) leading to good course, (d) carried out with necessary degree of loyalty and (e) not in breach of good morals. When judging if a member of a statutory body acted with the required care of diligent manager, it will have to be judged against degree of care provided by other reasonably diligent person in the same situation, if such person was in the position of the member of statutory body.
- **Absence of approval of the General Meeting** for legal acts render such acts invalid while such invalidity may be claimed within 6 months from the day the person authorised to claim such invalidity learned about it, and no later than within 10 years from the relevant legal act. It is therefore relative invalidity, not absolute (“automatic”) invalidity.

- In case of absence of prior approval of a controlling body, where such approval is required by law or Articles of Associations, such absence does not lead to invalidity, but constitutes liability of the members of the controlling body for damage caused to the company, which substitutes in this case the liability of the members of the statutory body.
- **Execution of an agreement without the expert evaluation prescribed by law or in breach with such expert evaluation will not lead to invalidity of the agreement**, but will constitute a right of the party to whose protection such expert evaluation shall serve to claim settlement (compensation) from the other party. The settlement must be claimed no later than within 3 months from the date on which the harmed party will learn that the price had been lower than according to the expert evaluation (in any case no later than within 10 years from the execution of the agreement).
- **Quorum**—the presence of a majority number of the members of the collective body is required for the decision making process; other than presence in person is sufficient—so-called distant vote. No majority presence is required if the scope of activities of the individual members of the relevant body is divided into different areas—in other words, if one area is the responsibility of one member(s), the presence of the other members that are not responsible for the relevant area is not required for the decision-making process for that specific question.

## **Conflict of interests, end of Section 196a of the Commercial Code**

The BCA does not assume the existing regulation of intra-group transactions under 196a of the Commercial Code, which remains controversial after all these years of its application. Furthermore the BCA abandons *the requirement for consent of the General Meeting or Supervisory Board for transactions the value of which exceeds 1/3 of assets*. As replacement of the above said provision, the BCA introduces certain mechanisms that are to regulate intra-group transactions (next to the generally applicable rule of the care of diligent manager applied to members of corporate bodies):

- Verification of signatures on agreements entered into between a single member company represented by its sole shareholder and the shareholder;
- absence of the consent of the supreme body of the corporation leads only to relative invalidity;
- absence of the consent of the controlling body of the corporation leads to liability of those members of the controlling body that did not act with the care of diligent manager;
- executing an agreement without a required expert opinion leads to relative invalidity of the agreement and the obligation of the relevant party to compensate any economical damage;
- in case of conflict of interest the member of the corporate body must inform the corporation and it is possible to temporary suspend any running office term (this fact will be registered in the Commercial Register);
- entering into agreements between a member of a corporate body and the corporation is

- subject to notification and the relevant body may forbid such an agreement;
- for JSC the BCA introduces special rules for assets transactions (see below).

The key rule for conflict of interest regulation is that breach of notification obligation does not lead to invalidity of the relevant legal act, but to liability of the member of the corporate body. In cases where the law declares invalidity, it is relative invalidity and the BCA sets out who may claim such invalidity and during which period they may claim it.

## **Intra Group Transactions**

The BCA sets requirements *for acquiring (not transfer) of company's assets from its founder or shareholder during a two year period from its foundation for a price exceeding 10 % of the subscribed registered capital:*

- the price cannot exceed the value of the acquired assets determined by expert evaluation; there are certain exceptions from the requirement for expert evaluation such as transactions in which the real value of assets is shown in the accounting of the company; and
- the transaction, including its price, must be approved by the General Meeting.

There are certain exceptions from the above requirements, similar to those specified in the existing Commercial Code (for example acquisition of assets within ordinary course of business, etc.). Failure to comply with the statutory requirement for intra group transactions does not lead to invalidity

of the transactions, but triggers possible liability of the members of the statutory body and the founder or shareholder must return to the company the sum by which the price exceeds the price set by the expert evaluation.

### **New risks for members of company's bodies:**

- obligation to return to the company all benefits acquired as a result of breach of their duty to act with care of diligent manager; if not possible monetary compensation must be provided;
- disqualification from the office of a member of corporate body due to breach of duty to act with care of diligent manager—by court decision;
- obligation to return to the company all benefits earned from the company (on the basis of executive (service) agreement or other benefits) during the period of two years preceding a final and legally valid court decision on the declaration of the company's bankruptcy, provided the member of the relevant body knew or should have known about the threatening bankruptcy and did not take any necessary measures; this rule will not apply retroactively, i.e. it will commence as of January 1, 2014;
- personal liability for any debts of the company in case of breach of disqualification from the office;
- unlimited liability for any debts of the company in case of company's bankruptcy, provided the member of the relevant body knew or should have known about the threatening bankruptcy and did not take any necessary measures;

- personal liability to the creditors of the company for any debts of the company, provided the member of the corporate body did not compensate to the company damages caused by the breach of his obligation to act with the care of diligent manager.

### **Settlement amount (in Czech *vypořádací podíl*)**

The settlement amount is based on the financial statements; however, this rule does not apply in cases where the fair value of the assets of the Company substantially differs from its book value—in this case, the amount is based on the fair value of the assets.

### **Holding structure (concern)**

- emphasis on real status—end of contractual syndicates (controlling agreements and agreements on profit transfer);
- three levels of business grouping:
  - (i) interference (any influence, can be single-actioned);
  - (ii) controlling (repeated actions; the BCA sets examples who is classified as controlling party);
  - (iii) concern (united management, i.e. influence of the controlling party on the activities of the controlled party with the aim of long-term enforcement of concern's rights under concern's politics);
- members of the concern are obliged to notify about the existence of the concern on their websites otherwise they will not be able to apply statutory benefits for concern participation

(such as exemption from the obligation to compensate damages caused to the company due to concern relations, etc.);

- benefits for concern participation: possibility to give business management instructions to the controlled party which are in favour of the controlling party or other party from the concern; possibility to compensate damages by other benefits arising out of concern participation. (i.e. not only financial, but also in-kind or other form of compensation of damages is allowed—for example more favourable supplier terms and conditions).

### **End of controlling agreements**

On the basis of BCA all controlling agreements and agreements on transfer of profit shall cease to exist on the last day of the accounting term of the controlling person, which follows immediately after June 30, 2014 (where a financial year corresponds to a calendar year, it will be as of December 31, 2014).

### **Report on related parties' transactions**

Obligation to execute such a report within 3 months from the end of accounting term has been kept; the BCA requires more information to be included in the report and explicitly requires the statutory body to specify therein and provide for explanation if it did not have sufficient information available for the preparation of the report.

## **Executive's (Service) Agreements**

Corporations and the members of their statutory bodies must agree on modifications of their executive's agreements otherwise the execution of the office of the statutory body will be considered as of July 1, 2014 carried out for free. Both parties have 6 months from the effective date of the BCA to agree on all necessary modifications. Newly, any remuneration provided to members of statutory bodies for the execution of their office can be provided only if specifically agreed under the executive agreement entered into pursuant to the relevant provisions of the BCA. We will provide more information about the subject of executive's agreements and the new law in one of our following newsletters.

## **Publishing**

Obligation to publish certain information remains fulfilled by publishing in the Commercial Journal. In addition to this the BCA also requires certain information to be published on the website of the company (obligatory for JSC; optional for LLC, but provided LLC have its own web pages, it must publish information prescribed by law there).

## **Changes of Articles of Associations by Board of Directors**

When the actual change of the wording of the Articles of Associations cannot be recognised from the decision of the General Meeting, the Board of Directors must put the wording of the Articles of Associations in compliance with the purpose of the decision of the General Meeting.

## Shares

- new mandatory item in the list of shareholders are the bank details for the purposes of dividend payment;
- possibility to issue unit shares (in Czech *kusové akcie*), which have no nominal value and cannot be issued together with nominal value shares; such shares represent equal share in registered capital (i.e. share in registered capital according to the number of shares);
- greater flexibility to determine different type of shares—BCA abandoned the exhaustive list of type of shares, it expressly refers only to common shares (i.e. shares without any specific rights attached), preferred shares and employees shares and furthermore provides for demonstrative list of specific rights (types), such as different, fixed or subordinated profit share, different number of votes attached to the share;
- the BCA also mentions forbidden type of shares—company cannot issue shares that have a right with specific interest independent of the economical results of the company attached to them;
- shares of the same nominal value can have different specific rights attached to them and shares with specific rights form one type of shares and all owners of the same type of shares must be treated equally; the Articles of Associations must described all different types of shares issued by the company, together with the descriptions of rights attached to such shares.

## Bodies—Dualistic or Monistic system

- **General Meeting** remains as the supreme body of JSC + the company may opt for Dualistic system = Board of Directors + Supervisory Board, or Monistic system = Administrative Board + Statutory Director. Companies are not obliged to expressly (actively) opt for one or the other system, but in the absence of such selection or in case of doubts with respect to the Articles of Association interpretation, it is presumed that the company opted for dualistic system.
- **Dualistic system** (Board of Directors + Supervisory Board)
  - Similar to today, but employees do not elect members of the Supervisory Board (this applies also to companies with more than 50 employees);
  - Number of the members of the Supervisory Board does not need to be a multiple of three; the Supervisory Board as well as the Board of Directors may have one member only;
- **Monistic system** (Administrative Board + Statutory Director)
  - In summary the Board of Directors is represented by the Statutory Director and the Supervisory Board by the Administrative Board or the chairman of the Administrative Board;
- **Administrative Board:**
  - Three members (Articles of Associations may provide otherwise, minimum one member), appointed by the General Meeting;

- Decides on general business management of the company and supervises executive management;
- its activities are organised by the chairman of the Administrative Board;
- **Statutory Director:**
  - Is the statutory body, is appointed by the Administrative Board; executes business management;
  - Can be also the chairman of the Administrative Board; provided the Administrative Board is a single member body, represented by the same person as the Statutory Director, it is possible to have only one person appointed into the company's corporate bodies.

### **Profit Share**

For certified registered shares payment of profit share only via bank transfer to the bank account specified in the list of shareholders.

### **Financial Assistance**

Likewise to date the possibility to provide financial assistance must be allowed by the company's Articles of Association and must comply with statutory prescribed terms (by way of example financial assistance cannot lead to bankruptcy of the company), the law newly refers to even-handed market conditions instead of general terms of business relations, particularly with respect to interest bearing of the financial assistance.

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.

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