

VK&t

NEWSLETTER NO. 6 – RECODIFICATION

Dear clients,

The subject of this newsletter is to outline to you the summary of major changes affecting limited liability 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 innovations and changes for limited liability 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 LLC**—existing memorandum 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 memorandum 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 memorandum of associations new mandatory provisions prescribed by the new law. In case of default, the Commercial Register may set a corrective period and if no remedy is ensured for during that period, the court may proceed with involuntary liquidation of the company.
- **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 memorandum of associations.** 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 unapplied by the shareholders in the memorandum of associations). 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 original 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 original law.

Our recommendation is to carry out extensive review of your existing memorandum of association and the data registered in the Commercial Register and put in compliance the data that are in breach with the new law within the set periods. Most commonly this will apply to the following:

- specifying the exact number of executive directors,
- modifying your service agreements with the executive directors of the company to have these complaint with new law,

- option to set non-competition rules for the corporate bodies of the company,
- option to set rules for transfer of ownership share in the company if the shareholders wish to have control over the transfer,
- registration of residency address of the members/directors of the company if different from their registered address,
- possibility to cancel reserve fund,
- depositing missing documents with the collection of deeds of the Commercial Register.

Below follows selection of other major innovations relating to the operation of LLC under new law. These innovations are to be effective as of January 1, 2014 and will be applicable to foundation and operation of new companies, but at the same time also the operation of existing companies—in some cases transitional period will apply (by way of example amendment of memorandum of associations must be procured for till June 30, 2014), the new law will, however, apply in most cases as of January 1.

Even in cases when it is not required by law to amend the memorandum of association to bring it in compliance with the new law, it is advisable to consider whether certain novelties introduced by the BCA can be in anyway useful for the operation of your company, particularly as you have a chance to create different types of ownership shares within the company. All such changes will require the amendment of the memorandum of association.

Registered Capital

As of January 1, 2014 the law does not prescribe minimum amount for registered capital, respectively the minimum amount of shareholder's contribution is CZK 1 as opposed to CZK 200,000 and the minimum registered capital of CZK 200,000.

End of linking ban and the limitation of number of shareholders of LLC

The BCA abandons the linking ban and further limitations under Section 105(2) of the Commercial Code under which one natural person cannot be single shareholder in more than three LLCs and at the same times cuts out the maximum possible amount of shareholders in a LLC (Section 105(3) of the Commercial Code).

New requirements for memorandum of association

The BCA requires certain new provisions which must be now included in the memorandum of association and which the original law did not require.

This concerns the following provisions:

- specification of types of ownership shares (provided the memorandum of association allows for different types of ownership shares to be created),
- naming of different types of the ownership shares,
- specification of number of executive directors,
- nomination of person appointed as the evaluator for in-kind contribution.

Types of ownership shares

As of January 1, 2014 the ownership share is referred to only as the share (*podíl*). The BCA introduces the possibility for LLC to have different types of shares, while one shareholder may hold number of different types of different or the same shares.

The possibility to create different types of shares *must be determined in the memorandum of association of the company*, where it must also be specified what rights and obligations are attached to the specific type of share and how is the percentage of the share determined. The BCA itself does not determine different types of shares and leaves it to the needs of the company. Next to the *basic share*, which will not have any special rights attached to it, it will be possible to

create different types of shares, which will better reflect the ownership structure of the company and the extent of participation of the individual shareholders in the company, *for example shares that will have profit priority right or set profit share right, shares without any contribution outside registered capital obligation or shares which will have higher degree of executive powers or veto rights, etc.*

Equity certificate (*kmenový list*)

The BCA allows embodying the share into so called *equity certificate (kmenový list)*, i.e. if determined by the memorandum of association the company may issue order certificate, which will represent the share in the company. In such case the share is transferred by signing an order paper and handing over of the certificate. The equity certificate may be issue only for shares the transfer of which is not in any way limited or conditioned and the equity certificate must represent individual share in the company. The equity certificate may be issue also in the form of collective certificate. The BCA puts a ban on public offering or public trading with the equity certificates.

Administration of contributions

Next 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 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.

Transfer of ownership share to other shareholder or third party

As of January 1, 2014 the rules for granting of an approval with the transfer of the ownership share are being changed:

- **to other shareholder**—newly, each shareholder may transfer its share to other shareholder without a need to obtain a consent of the general meeting (the Commercial Code required such consent), unless the memorandum of association requires to obtain an approval of the corporate's body,
- **to third party** (which is not a shareholder in the company)—under the original law the transfer of share to a third party must had been determined in the memorandum of association and had been subject to consent of general meeting. Newly the transfer of the

share to a third party will be allowed, regardless whether such possibility it is determined in the memorandum of association, but the consent of the general meeting will be mandatory, unless exempted by the memorandum of association.

As specified above, the transfer of share represented by an equity certificate will be carried out by signing of an order paper and handing over of the certificate. This is of course unless the memorandum of association provides otherwise.

Profit Share

Although the BCA does not include an expressive requirement to decide on profit distribution on the basis of the relevant closing of accounts statement within 6 months from the date it had been issued (as ruled 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.

The right to profit share is the fundamental right of the shareholders of the company and remains not significantly changed by the new law. The profit share ration is *determined according to the ratio of the shareholder's share to the registered capital of the company, but the memorandum of associations may provide otherwise*. The Profit share is to be *paid out in money*, but the memorandum of associations (or decision of general meeting) may also allow for *in-kind profit share*.

As mentioned above, the BCA allows the company to pay out profit share without a decision of general meeting, subject to having in the memorandum of associations specified ownership shares which are entitled to fixed profit share. The profit may be distributed only if the economic results of the company in the relevant financial year allow for the distribution.

The company may newly pay out profit share deposit payments, subject to obtaining interim closing of account 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, i.e. it cannot be higher than the sum of the economic result of general financial year, undistributed profits of last year and other profit funds, lowered by the sum of unpaid losses from previous years and mandatory payment to reserve fund. The company may not use for profit deposit payments any monies from its reserve funds created for other purposes nor any of its own funds which are purposefully tided. If a profit deposit payment is paid out in breach with the statutory provisions, the shareholder is obliged to return any such deposit received.

Contributions outside registered capital

This area is being significantly changed as of January 1, 2014. Until the end of 2013, the contribution outside registered capital could have been ordered up to the maximum amount of 50% of the registered capital. Newly, the memorandum of association will have to determine whether the

shareholders can be ordered to pay contributions outside the registered capital and up to which amount such payment obligation can be ordered to them. *Terms and conditions for this are to be determined in the memorandum of association.*

This means that if the possibility to order the payment of contributions outside registered capital is not set in the memorandum of association, it will not be possible as it is presumed that the memorandum of association does not allow for this.

The memorandum of association must also set to which type of ownership shares will be such obligation attached. *Therefore when acquiring any ownership shares in a LLC, you must also carefully consider whether you may be ordered in the future to pay any contribution outside registered capital and up to which amount.*

The BCA has a new rule under which the shareholder who did not vote for the contribution outside registered capital and does not wish to pay such contribution, may step out of the company (in respect to his individual share).

Regarding voluntary contributions, these can be provided by the shareholders at any time and without any limitations, unless the memorandum of association provides otherwise (by way of example it can be exempt, allowed for only certain types of shares, limited, etc.). The only statutory requirement for the voluntary contributions *is the mandatory consent of the statutory body of the company (one or more executives)* (until now the consent of the general meeting was required).

Voluntary contribution may be newly provided also in the form of in-kind contribution, while the value of such contribution will be set according to the expert evaluation procured in the same manner as if evaluating in-kind contributions to the registered capital.

Reserve fund

The BCA no longer requires for the companies to mandatory create reserve funds, i.e. no need to set part of the generated profit aside into a reserve fund. Existing reserve funds may be dissolved, in compliance with statutory prescribed terms, and may be used according to the needs of the company, for example paid out to the shareholders, transferred to the account of undistributed profit, etc.

Statutory bodies

- The statutory body of the LLC is each of its executives, unless the memorandum of association appoints the executives as collective body. The BCA expressly vests to the powers of the executive *the business management of the company and procuring for prescribed accounting evidence of the company*.
- 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 is 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. The members of the controlling body will be liable to the damages only if such approval (while acting with care of diligent manager) should have been granted.
- *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 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 shareholder who hold at least one half of all votes is required for the decision making process of the general meeting; The BCA *expands the possibilities how can the shareholders participate in the general meeting*. Besides the standard personal attendance of the general meeting or voting per rollam, the memorandum of association may also allow for other methods of participation such as voting by electronic means, through videoconference, social networks, etc. The condition for effectivity and validity of such vote is that you must be able to verify the identity of the voting parties and of the votes as such. Shareholder who is not present to the general meeting may execute his voting right ex post, provided he will send his vote to the company in writing within a period of 7 days from the general meeting.

Conflict of interest, 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. As replacement of the above said provision, the BCA introduces certain mechanisms that are to regulate intra-group transactions (so called Insolvency Test) and rules for wrongful trading (see below).

Non-competition

As opposed to the existing law, which put total ban on the executives to be in completion relation with the company (such as be engaged in a different company with the same scope of business

activities, broker trade for other entity, etc.), the new law allows for the executive to carry out competitive activity provided all shareholders of the company will be informed in advance and none of them will raise their objections within one month period from notification.

New risk for the executives—particularly the following:

- 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 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 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 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 or 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 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.

Insolvency Test

The company may not pay out any profit or other funds or provide any deposit payments for these if it can lead to bankruptcy under the Insolvency Act. Breach of this condition will lead to liability of the shareholder who accepted such payment and new about the breach of the above condition. The shareholder will be obliged to return all paid profits. The acts of the executive director may be in such case classified as breach of the duty to act with care of diligent manager and can establish his personal liability for the paid out sum.

Service Agreements

Corporations and the members of their statutory bodies *must agree on modifications of their service'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 previous newsletters.

Web pages as mandatory obligation

As of January 1, 2014 all joint stock companies must have their own web pages on which they will publish information that must be shown on their business documents, i.e. this obligation is not mandatory for LLC. *If LLC has its own web pages, it must publish the same scope of information as prescribed by law for the joint stock companies.*

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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