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Amendment to Act on Commercial Corporations

Dear Clients and Partners,

Please, be informed that on 1 January 2021 Act No. 33/2020 Sb. which amends the Act on Commercial Corporations[1] became effective (hereinafter the „**Amendment** "). We would therefore like to provide you with a brief overview of the main changes awaiting commercial corporations this year, in particular with regard to the following matters:

1. ONE-TIER CORPORATE GOVERNANCE STRUCTURE

Previous regulation of one-tier corporate governance structure of joint-stock companies required that these companies shall set up two corporate bodies – a Statutory Director and a Board. The Amendment **did away with the position of a Statutory Director**, whose responsibilities are fully taken over by the Board. The Board will remain the only governing body of joint-stock companies that use one-tier corporate governance structure.

Cancellation of the position of a Statutory Director was automatically reflected in the Commercial Register and all individuals who, as of the end of last year, served as Statutory Directors were struck off the Commercial Register. **Memorandums of Association must be aligned with the new legislation and the changes must be entered in the Commercial Register.** This must take place at the latest on the day new Board members are elected or on the day the number of Board members set by the Memorandum of Association is first changed.

From 1 January 2021, Statutory Directors lost the power to represent their companies (and their access to the company's data mailbox was revoked), unless they simultaneously also served as Chairpersons or Members of Board authorized to act on behalf of the Company. Therefore, should your company wish to be represented by the same person who, prior to the effective date of the Amendment, served as a Statutory Director but was not a Board Member, it must appoint this person to the Board.

[1] Act No. 90/2012 Sb., on Commercial Corporations („ACC").

The law says that all Board Members are entitled to represent their Company. This statutory authorization may however be changed in the company's Memorandum of Association and given only to some Board Members. Thereby, the rest of Board Members will only be authorized to decide on the general business direction of the Company and will retain their supervisory powers. Such a change must be registered in the Commercial Register.

2. EXECUTIVE SERVICE AGREEMENTS

Executive service agreements should also be revised for several reasons. The first reason follows the change in the one-tier corporate governance system of a joint-stock company described above. Since a Statutory Director's executive service agreement ceases to exist together with the position of Statutory Director, a Statutory Director who was paid under an executive service agreement and will continue to be remunerated for his/her position of a Chairman or a Member of Board, should have his/her remuneration included in the respective executive service agreement entered into for the new position. Otherwise, the position of a Member or Chairman of Board will be deemed unpaid.

The Amendment expressly enacted what has, up till now, been only based on court practice, i.e., that **executive service agreements of members of elected bodies of limited liability and joint-stock companies do not become effective before they are approved by the General Meeting**. The exact effective date of an approved agreement is the date of its execution or appointment of the respective member to the executive position, depending on which of these dates occurs later. Due to this, **it is not necessary to have the remuneration paid to members of corporate bodies before the approval of their executive service agreements by the General Meeting approved separately**. Where an executive service agreement is not entered into for reasons on the part of the commercial corporation, the member of the elected corporate body of the limited liability or joint-stock company will be entitled to remuneration which would be considered standard at the time of their appointment into the position.

3. DISTRIBUTION OF PROFIT AND OTHER EQUITY

Reflecting a rule established by the Supreme Court of the Czech Republic, the Amendment expressly states that **profit shown in extraordinary or annual financial statements** may be **distributed at any time before the end of the accounting period following the accounting period for which the financial statements have been drawn up.**

However, the requirement that profit or other equity shall be distributed only if the General Meeting approves so survives. The General Meeting must base its decision on a „**balance test**". The balance test requires that the aggregate of the company's economic results in the last completed accounting period, economic results in the previous years and other funds which a limited liability company, a joint-stock company or a cooperative may establish at their discretion, minus mandatory contributions to reserve funds or other funds must exceed the amount intended for distribution among shareholders.

In order to be able to distribute profit or other equity, limited liability companies, joint-stock companies and cooperatives must also carry out an „**equity test**", which has until now been mandatory only for joint-stock companies. The test requires that a company's equity shall not drop under the total value of the registered capital of the company and funds which, according to statutory provisions or the company's Memorandum of Association, cannot be distributed.

Under the Amendment, any decision of the General Meeting which would not respect the results of the above tests will automatically become ineffective. Should the company's governing body nonetheless decide to distribute profit or other equity based on such a decision, the payments received by shareholders (or members of a cooperative) will represent unjust enrichment. The members of the governing body who agreed to such distribution in violation of the ACC did not act with due care. Therefore, a violation of the rules for the distribution of profit may lead, among others, to the liability of the members of the governing body for damage.

Prior to payment of profit or share in profit or other equity, the governing body continues to be obliged to carry out an „**insolvency test**". Neither profit nor any share in equity may be paid if it could render the company or cooperative bankrupt, i.e. insolvent or over-indebted.

4. LIABILITY OF MEMBERS OF GOVERNING BODIES IN CASE OF CORPORATE INSOLVENCY

If a member of a governing body failed to act with due care and take all reasonable and necessary steps to prevent its company's insolvency and the company indeed became insolvent as a result, the old legislation established secondary liability of such a member.

The relevant factors establishing such a member's liability now are (i) member contributing to the company's insolvency by the breach of his/her obligations, (ii) company being declared insolvent by a court and (iii) liquidation being ordered to resolve the company's insolvency. If the above conditions are met, **the respective member of the company's governing body will no longer be secondarily liable, but may instead be sued by the insolvency administrator to pay the difference between the total debts and total assets of the company to the insolvent estate. The filing of such action is at the discretion of the insolvency administrator. However, the action must be filed mandatorily if the creditor committee decides so.**

This makes the process of holding a member of a company's governing body liable easier as opposed to the situation prior to the Amendment, when it was necessary to first sue for declaration of secondary liability and only then (or simultaneously) for payment based on the secondary liability.

The exact amount which the liable member of the governing body will be obliged to pay to the estate will depend on the difference between the total debts and total assets of the company and on the extent to which the member's breach of his/her obligations contributed to the company's insolvency.

A possible liability of a member of a governing body is thereby limited and cannot exceed the difference between the debts and the assets of an insolvent company in liquidation. As for creditors, their position under the new regulation may be somewhat weaker than before, as their claims will be

satisfied only if a suit is filed by an insolvency administrator. **Individual lawsuits against members of governing bodies filed by individual creditors of the company are not permitted.**

The option of the insolvency administrator to sue a member of a governing body to return remuneration or other consideration received from the company under an executive service agreement, as well as any other profit, in the two years prior to the initiation of the insolvency proceedings into the insolvent estate remains open both in liquidation and reorganisation procedures.

5. SHARES WITH DELEGATION RIGHTS

Delegations rights are shareholders' rights to appoint or remove a certain number of members of a corporate body, regardless of how many votes in the company the shareholder has or how big the size of his/her share in relation to the registered capital of the company is.

The Amendment expressly allows limited liability and joint-stock companies to introduce shares which entail rights to appoint or remove one or more members of an elected body of the company. Detailed conditions, such as the number of members of a corporate body which may be appointed/removed by a shareholder with delegation rights, must be specified in the company's memorandum (or, respectively, articles) of association. However, at least one half of members of an elected corporate body must still be appointed by the General Meeting.

In limited liability companies, delegation rights may be introduced or changed by consent of all shareholders. The consent of three quarters of all shareholders is required in joint-stock companies.

Shareholders with delegation rights may appoint members of an elected corporate body in writing with a certified signature. Members of governing bodies appointed by shareholders with delegation rights may be removed by the General Meeting only in exceptional cases (for example if the corresponding delegation right ceases to exist).

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We hope that our newsletter provided you with useful information and we are ready to assist you to find the right solution for any situation you may encounter.

Your LTA team