

Legal Update

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The information in this newsletter is correct to the best of our knowledge and belief at the time of going to press. Specific advice should be sought, however, before investment and other decisions are made.

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We firmly believe you will find Legal Update to be a useful source of information. We're always interested in receiving your views on this bulletin, in particular its content, format and frequency.

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SELECTED BILLS BEFORE CZECH PARLIAMENT

Bill on the abolition of physical bearer securities

A group of MPs has submitted the Chamber of Deputies with a bill on the abolition of physical bearer securities. The bill justifies the abolition of bearer securities primarily citing the detrimental anonymity of their owners, which is – allegedly – often associated with criminal activity.

The bill introduces two ways to replace physical bearer securities that have already been issued: a) a change in form to physical registered securities, a procedure that would remain fully in the power of the given company's Board of Directors, or b) a change in form to book-entry bearer securities pursuant to Act No. 256/2004 Coll. on the capital market. The latter method would become obligatory for abolishing physical bearer securities, where the change-over has not been executed voluntarily during the statutory transition period.

The bill envisages a change in § 156 par. 1 of the Commercial Code, expanding its current wording and elaborating the term bearer securities, which, in the proposed wording, would be issued exclusively in book-entry form.

The securities change-over should take place within a statutory 12-month (transition) period during which the General Meeting of a joint stock company with physical bearer securities would decide whether to change the type or the form of these securities. Should the General Meeting opt to exchange the physical

bearer securities, it would have to do so within six months of adopting such decision.

The bill further assumes that if physical bearer securities are not exchanged for securities of another type or form within the statutory time-limit, then all physical bearer securities would by law be changed to book-entry bearer securities under the presumptive regime in § 112 of the Capital Market Act as at 1 January 2012.

SELECTED EUROPEAN LEGISLATION

Regulation on governing law for non-contractual obligations

On the 11th of January, long-discussed Regulation No. 864/2007 of the European Parliament and of the Council, which stipulates the basic rules for determining the law to be applied to non-contractual civil and commercial obligations with an international component, came into force. The Rome II Regulation follows harmonisation of the establishment of governing law for the area falling within its competence, which, in addition to unjust enrichment includes, inter alia, liability for damage caused by product defect, acting without mandate or liability for acts preceding contract execution.

The Regulation does not apply, for example, to non-contractual obligations ensuing from the law on business companies and cooperatives, in particular in respect of the establishment or dissolution of these entities, the enjoyment of legal capacity, organisational structure or personal liability of members of statutory bodies. In such cases, national law shall prevail: in the case of the Czech Republic, the Act on International Private and Procedural Law.

The rule for determining governing law is contained in Article 4 and applied where not otherwise stipulated in the Regulation. The governing law shall, in the first instance, be the law of the country in which damage was incurred, irrespective of where the fact estab-

lishing the incurred damage arose or where the damage was secondarily manifest. The key determinant is further regulated in that if it is clear that a civil delict is closely associated with another country, then the law of this other country shall apply. Hence, this would be the case if a contract executed by parties is closely connected with a given civil delict.

The Regulation stipulates rules of priority for a number of areas including (as mentioned above) damage caused by product defect, agency without mandate as well as unfair competition or liability for environmental damage.

The Regulation allows a certain degree of contractual freedom in the ability to choose the law that is to govern a non-contractual obligation. However, the choice of law is not unrestricted and every instance must take account of individual provisions of the Regulation. Generally, once a fact leading to the establishment of a non-contractual obligation arises, persons conducting business activity and persons not conducting such activity shall be equally able to agree on the governing law. Parties will generally prefer such selection where the governing law would otherwise be less favourable for both of them. Only persons conducting business activity may agree on such an arrangement before such fact arises, and it shall have to have been done voluntarily. The parties must ensure that the choice of law was sufficiently specific and not detrimental to any third party.

RECENT CASE LAW

This section contains selected summaries of recently published legal decisions pertaining to business law. The text of these decisions has been edited for the purposes of publication.

On the invalidity of a contractual fine in relationships subject to business law

A grand chamber of the Supreme Court concluded in a decision that a contractual fine in relationships subject to business law may not be considered as invalid for violation of good morals pursuant to § 39 of the Civil Code only due to the unreasonableness of its agreed amount. In the Supreme Court's opinion, such situations are addressed by the provision of § 301 of the Commercial Code regulating the discretionary power of the court, which stands as a special provision in relation to § 39 of the Civil Code inasmuch as it is directed toward factual cases in which the parties to a business relationship have agreed an unreasonably high contractual fine amount.

The Supreme Court further stated that an arrangement on a contractual fine may be deemed invalid pursuant to § 39 of the Civil Code only where the circumstances under which the contractual fine was agreed breached good morals, including in connection with the fact that an unreasonably high contractual fine was agreed. The court substantiated the foregoing, inter alia, by the fact that in relationships governed by business law, the provisions on contractual fines pertain only to

situations in which the obliged party is an entrepreneur, i.e. a professional who is necessarily cognisant of the economic risk inherent in an agreement on a contractual fine, and is therefore subject to stricter conditions of liability than are applied to a non-entrepreneur. Thus, the peremptory provision of § 301 of the Commercial Code preferences preserving the validity of a legal act, even in the case of an unreasonably high contractual fine amount, and only establishes the possibility of mitigation. If other circumstances do not arise, then the provision of § 39 of the Civil Code cannot be applied to an unreasonable contractual fine amount.

Supreme Court Grand Chamber Decision No. 31 Cdo 2707/2007 of 14 October 2009

On the content of a report on relationships – contracts between a controlling and controlled person

In this decision, the Supreme Court opined on the degree of specificity of contracts between a controlling and controlled person disclosed in a report on relations between related parties ("*related parties report*") and on serious reasons for a review of such report.

The content requirements of the related parties report are stipulated in § 66a par. 9 of the Commercial Code ("CC"), where the degree of specificity always depends on the specific relationships of the given controlled company. In its judicature, the Supreme Court stated that if shares constituting a decisive part of assets of a controlled person are transferred by that controlled person to the controlling person, then general information on the execution of contracts on the sale of shares for a price determined by an expert will not suffice. In such a case, the related parties report should, at the very least, include information on the issuer and number of shares involved.

Pursuant to § 66a par. 13 of the CC, every partner or member of a controlled person may ask a court to appoint an expert for the purpose of reviewing a related parties report (§ 66a par. 12), but only in cases therein defined. The provision of § 182 par. 3 of the CC expands this authorisation to include a specific group of shareholders mentioned in § 181 par. 1 of the CC who may request an expert appointment even where the conditions set out in § 66a par. 13 of the CC have not been met.

Such serious grounds in the meaning of § 182 par. 3 of the CC could be justified and serious doubt as to the accuracy of the assertion in a related parties report that the controlled person suffered no detriment as a result of a contract concluded between related parties. If a significant portion of the assets of a controlled person is transferred to a controlling person for a price determined in an expert valuation that is, nonetheless, many times lower than the price determined by another expert, this constitutes reason to doubt the equivalency of the contractual performance of the controlling person to the controlled person and thus to question whether the controlled person potentially suffered detriment as a consequence of this transaction.

Supreme Court Ruling No. 29 Cdo 3887/2008 of 23 October 2009

On breach of good morals as grounds for cancelling an arbitration award

In a recent decision, the Czech Supreme Court opined on the possibility of a merits review by an arbitration (general) court, in particular on the interpretation of grounds for revocation pursuant to § 31 letter f) of the Arbitration Act (the "AA"). The Supreme Court educed that a (general) court cannot reverse an arbitration award pursuant to the foregoing provision for performance of the imposed arbitration award being (allegedly) in breach of good morals.

In the given case, the claimant sought the cancellation of an arbitration award because he had been sentenced in the award to pay a contractual fine in an (allegedly) indecent amount. The court of first instance rejected the suit. However, the second instance court agreed with the claimant's assertions, changed the ruling and cancelled the arbitration award.

In its ruling, the Supreme Court, inter alia, cited the interpretation of § 31 letter f) of the AA. According to this provision: "*A court shall, when petitioned by any party, cancel an arbitration award if the arbitration award sentences a party to performance that was not required by the authorised party or to performance that is impossible or impermissible under domestic law*".

The Supreme Court concluded that the impermissibility of performance according to the cited provision must be interpreted in the sense of the subject of the obligation, i.e. the performance of the defendant, and not the sense of the circumstances owing to which the exercising of the right to the required performance should be denied. It further explained that impermissible performance must be understood to include performance not approved by domestic law. According to the cited legal decision, such performance would include performance limited to certain entities, in particular the state, or that is subject to government oversight or permission and banned from handling. Such performance would include anything related to explosives, firearms, drugs, mineral resources, human body parts, etc.

In the rationale for its decision, the Court, inter alia, cited the intention of the lawmakers, which, in the Court's opinion, was to preclude a judicial review of the material correctness of an arbitration award. The Court stated that the legal treatment of arbitral proceedings would make no sense if, in a proceeding on the cancellation of an arbitration award, the court were to review the award's legitimacy. The only authorised right of action against an arbitration award would be its review by another arbitrator pursuant to the provision of § 27 of the AA.

Supreme Court Ruling No. 33 Cdo 2675/2007 of 30 October 2009