Legal Update

April 2019

Weinhold Legal

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Legislative Amendments

Bill amending certain laws on the regulation of business in the financial markets

On 12 February 2019, the Government submitted a bill amending certain laws on the regulation of business in the financial markets to the Chamber of Deputies as Parliamentary Bulletin No. 398 (the “Bill”).

In particular, the Bill seeks to respond to the adoption of Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted for trading on a regulated market and on the repeal of 2003/71/EC (the "Prospectus Regulation"), which is set to come into force on 21 July 2019. The major part of the legal regulation addressing the security prospectus, contained primarily in the provisions of Section 34 et seq. of Act No. 256/2004 Coll., on capital market undertakings (“ACMU”), which transpose Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published upon a public offering or acceptance of transferable securities for trading and amending Directive 2001/34/EC (the "Prospectus Directive"), will be transferred to the Prospectus Regulation as a directly applicable legal regulation which is uniformly applied throughout the European Union from that date. Conversely, new offences committed by entrepreneurs and legal entities in connection with violating certain provisions of the Prospectus Regulation will be added to the ACMU.

The Prospectus Regulation itself is, in many ways, linked to the Prospectus Directive. In addition, however, it aims to facilitate access to the capital market for issuers, especially small and medium-sized enterprises (SMEs). As a rule, drawing up a standard prospectus is a costly and time-consuming process which requires the disclosure and processing of a vast amount of information, which can deter both issuers and potential investors alike. To this end, the Prospectus Regulation seeks to respond by introducing simplified schemes for the public offering of securities by certain issuers, namely in the form of a Union Growth Prospectus, as well as a simplified prospectus for secondary offerings. The EU Growth Prospectus is generally intended for SMEs, small-cap companies, or for those parties whose securities offering does not exceed a total consideration of EUR 20,000,000. The simplified prospectus for secondary offerings will be made available to issuers whose securities have already been admitted for trading on a regulated market (or the SME growth market) and for which a prospectus has already been drawn up. Based on the simplified prospectus, both equity securities (e.g. shares) and non-equity securities (e.g. standard bonds) may be offered under the conditions set out in the Prospectus Regulation. In addition, issuers who offer public securities on a regular basis will be able to user the so called universal registration document. Once approved, these issuers may limit the ambit of the prospectus to the description of the securities and the summary only.

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The Bill also amends Act No. 190/2004 Coll., on bonds (the "Bonds Act") in two respects. Firstly, all bond issues should now be assigned an ISIN (identification number under the International Securities Identification Numbering System) so as to ensure they are properly recorded. Secondly, the mandatory requirements of the issue conditions should state whether and to what extent the Czech National Bank ("CNB") oversees the issuance of bonds and their issuer, and (if the issue is subject to the obligation to publish a prospectus) a warning indicating that the CNB only approves the prospectus in terms of its completeness, not material accuracy.

More significant amendments should also be made to Act No. 240/2013 Coll., on investment companies and investment funds (the "AICIF"). One of the proposed changes is to simplify the arrangement of shareholders' meetings. Newly, the current demonstrative list of issues that may be decided by the Assembly of Shareholders should be removed and the determination of the scope of the Shareholders' Assembly should be left up entirely to the Statutes of the mutual fund. Changes should also be made to the legal regulation of the redemption of unit certificates (newly, for example, the statutes of a unit trust fund may set a period of up to five years from the creation of a fund in which the fund will not repurchase its unit certificates). It is also proposed that the investment shares of investment companies with variable capital ("SICAVs") should not be subject to voting rights unless the statutes specify otherwise. Other proposed changes include new rules for the SICAV bankruptcy procedure which create sub-funds, a more general regulation of the investment fund promoter, or the adaptation of the AICIF to Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds.

The aforementioned represents only selected changes that the Bill should introduce. As such, it also amends a number of other capital market (and related) regulations.

The proposed effective date of the Bill is the first day of the second calendar month following its pronouncement.

New European legal framework for securitization

On 1 January 2019, Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 establishing a general framework for securitization and establishing a specific framework for simple, transparent and standardized securitization and amending Directive 2009/65/EC (the "Securitization Regulation") entered into force. Together with related Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms, the Securitization Regulation is the new European legal framework for securitization.

The Securitization Regulation aims to revitalize the securitization market, whose popularity in the EU has fallen considerably since the 2008 financial crisis, when the abuse of securitization schemes was often referred to as one of its main causes. The Securitization Regulation newly regulates the entire securitization process, including transparency requirements for individual entities who are involved in securitization; securitization registration; a general re-securitization ban; and relatively strict rules for offering securitization investments to retail customers. Also, where it concerns institutional investors, the Securitization Regulation sets out a number of conditions that these investors must meet before becoming a holder of a securitization position, and thereafter whilst holding a securitized position.

Newly, a simple, transparent and standardized (STS) securitization legal regime has been introduced, with the main advantage being the lighter capital adequacy requirements of stakeholders.

Regulation establishing the framework for screening foreign direct investments headed for the European Union

On 21 March 2019, Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 on establishing the framework for screening foreign direct investments into the European Union (the "Review Regulation") was published in the Official Journal of the European Union.

It is the first comprehensive framework for screening foreign direct investments that is set out uniformly across the EU. The Review Regulation only applies to foreign direct investments from third countries headed for the EU, but not *vice versa*. Under this Regulation, Member States can establish various mechanisms needed to verify foreign direct investments in their territory for security purposes or public order. The rules which are applied as part of these mechanisms must be transparent and must not result in any discriminatory practices between third countries. Member States must report all such existing screening mechanisms to the European Commission by 10 May 2019; however, after which time the European Commission must be notified of any newly introduced mechanisms within 30 days from when they enter into force.

An important benefit of the screening regulation concerns the enshrining of an individual Member State's right to communicate formal remarks to the reviewing Member State should they have reason to believe that the foreign direct investment may pose a security or public order risk. In the event the European Commission believes that the foreign direct investment may pose a security or public order risk in more than one Member State, it may issue a formal opinion to the reviewing Member State. The Member State which is reviewing a direct foreign investment will be required to take the formal remarks of other Member States and the formal opinion of the European Commission into account. Nevertheless, the final decision made within the review mechanism will rest with that state.

The Regulation will enter into force on 11 October 2020.

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Recent Case Law

Suspending the exercising of rights attached to shares which a shareholder has not submitted for the purpose of indicating the necessary data or for making an exchange under the Act on Certain Measures to Increase the Transparency of Joint-Stock Companies

(Supreme Court Resolution No. 27 Cdo 1795/2018 of 31 Oct. 2018)

In this case, Party A ("Credit Provider") and Party B ("Credit Recipient") entered into a loan contract. In order to secure the debts to the credit provider, Party C ("Pledgor"), who was also the Chairwoman of the Board of Directors of the joint-stock company ("Company"), established a pledge over their certificated bearer shares which were issued by this Company ("Pledged Shares").

In 2015, the Company called upon its shareholders to submit their certificated bearer shares in exchange for registered shares. This was in response to Act No. 134/2013 Coll., on some measures to increase the transparency of public limited liability companies and on amendments to other laws ("the Act") having entered into force, which places a duty upon shareholders to submit their certificated bearer shares to the owner of the company for the purposes of indicating the necessary data or for exchanging them for newly registered shares, and to provide the company with the data necessary for making an entry in the list of shareholders by no later than 30 June 2014. At that time, the Credit Provider who had pledged shares as Pledgee, was aware of the call to submit its shares, however, failed to submit them in exchange for registered shares. Nevertheless, the Pledgor, who was also the Chairwoman of the Board of Directors at that time, confirmed in writing that the pledged shares had in fact been exchanged for registered shares (although they had not been) and made a note indicating this fact in the list of shareholders.

Subsequently, the General Meeting was convened, however, the authorized representative of the Pledgor was not permitted to attend, the reason being that he was not entitled to exercise shareholder rights inasmuch as the pledged shares had not yet been exchanged. Convinced that he was in fact entitled to exercise the shareholder rights (namely, to attend and vote at the General Meeting), the Pledgor made a formal request to have the resolutions which were adopted at this General Meeting declared null and void, notwithstanding the fact that the pledged shares had not yet been exchanged.

The Court of First Instance rejected the Pledgor's line of argument. In the Court's opinion, for the purposes of assessing whether the Pledgor was entitled to exercise voting rights at the General Meeting in question, it was not a decisive factor as to whether the pledge was registered in the list of shareholders, but rather only whether the pledged shares had been exchanged *de facto*. If a credit provider, as pledgee, has failed to submit the pledged shares to be exchanged, the law provides that the pledgor may only seek damages in such case, and not exercise the shareholder rights that are attached to these shares.

However, the Court of Appeals did not share the same view, stating that the shareholder's failure to fulfil its duty to submit the shares for the purposes of indicating the necessary data or for exchanging them could not occur if the Company was late in issuing the call requesting that the shares be submitted, or if the deadline for doing so had not yet passed. Thus, if the Company had only called upon its shareholders to exchange their shares in 2015 and then set a time period to comply between 18 May 2015 and 18 June 2015, the Pledgor could thus not have been late in submitting the pledged shares to be exchanged. *Ergo*, the Pledgor could not have been prevented from exercising the rights attached to the pledged shares.

In the subsequent appellate proceedings, the Supreme Court then considered whether the shareholder had failed to fulfil its duty to produce and furnish the certificated bearer shares for the purpose of indicating the necessary data or for making an exchange if the Company itself had been late in issuing the call for shareholders to submit such shares.

The Supreme Court concluded that a statutory sanction resting in the withdrawal of rights attached to the shares, which the shareholder had failed to submit within the statutory time period for the purposes of indicating the necessary data or for making an exchange may not depend on when (if at all) the Company had called upon the shareholders to submit their shares, nor the time period which the Company had stipulated and within which the shareholders had to duly submit their shares. This conclusion applies even in cases where the pledgor is in possession of certificated bearer shares at the time in question. The opposite interpretation is not supported by the legal text and is contrary to the intention of the legislature, which primarily pursues the public interest in terms of increasing the transparency of joint-stock companies. The aforementioned legislation was then described by the Supreme Court as being constitutionally conforming, although, despite its imminent encroachment upon shareholder ownership rights, is merely a limitation (not withdrawal) of that right, and only for a temporary period. The rights attached to the shares are "revived" as soon as the shares have been submitted to the company for the purpose of indicating the necessary data or for exchanging them for new shares, and if the shareholder informs the company of the data which is needed for making an entry in the list of shareholders. As regards a pledgee, the shareholder rights are protected under damage liability for any damage which is caused by shareholders by virtue of their failure to fulfil the duty to furnish the shares in question to the Company for the purpose of exchanging the shares or for indicating the necessary data.

As such, it follows from the aforementioned Supreme Court ruling that the Pledgor could not exercise the rights attached to pledged shares at the General Meeting in question, irrespective of the fact that the Company itself was late in issuing the call requesting that the pledged shares be submitted

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in order to exchange them. Entry in the list of shareholders alone is not sufficient to restore the rights attached to the shares, but a *de facto* exchange of the shares, or their having been submitted for purpose of indicating the necessary data, is also required.

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