Legal Update

November 2019

Weinhold Legal

Contents

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.

Banking and Financial Services:
Pavel Jendrulek

Mergers & Acquisitions:
Daniel Weinhold, Dušan Kmoch, Dalibor Šimeček

Litigation / Arbitration:
Milan Polák, Ondřej Havránek, Zbyšek Kordač

Information Technology and Intellectual Property:
Martin Lukáš, Jan Turek

Competition Law / EU Law:
Tomáš Čermák

Insolvency Proceedings and Restructuring:
Zbyšek Kordač, Vladimír Petráček

Labour Law:
Ondřej Havránek, Anna Bartůňková

Real Estate:
Pav Younis, Václav Štraser

We hope that you will find Legal Update a useful source of information. We would value your feedback on this newsletter, in particular its content, format and frequency.

Please e-mail any comments to david.hlavacek@weinholdlegal.com or contact your usual Partner or Manager.

Recent Case Law

Limits of the obligation to loyally perform the role of statutory body member

(Czech Supreme Court Judgment No. 27 Cdo 2695/2018 of 25 April 2019)

In this case, the Supreme Court dealt with the issue of due managerial diligence and the related duty of loyalty, i.e. the duty of a member of a company's statutory body to give priority to the interests of the company over his own or those of third parties. According to the Supreme Court, the duty of loyalty of a member of a company's statutory body is in force 24 hours a day, 7 days a week; therefore, such member should not without good reason undertake any act that is manifestly against the interests of the company, even where this does not occur during the member's fulfilment of his duties.

The applicant (a limited liability company) sought damages from the respondent (its executive), which the respondent was said to have caused by failing on the applicant's behalf to pay, in a timely manner, the rent for land that he himself (as a natural person) had leased to the applicant for agricultural use and for which the applicant had received land management subsidies.

Due to the delay in paying the rent, the respondent withdrew from the lease and, as a result of the expiry of the lease of the land in question, the State Agricultural Intervention Fund ordered the applicant to repay part of the subsidy it had received, which the applicant then deemed to be damage that it had incurred.

In its decision, the court of first instance stated that the respondent, as company executive, must or should have known that were he (as lessor) to withdraw from the rental agreement, the State Agricultural Intervention Fund would impose the obligation to return a part of the subsidy on the applicant. By withdrawing from the rental agreement, the respondent thus violated the duty of loyalty and, in the court's view, was obliged to compensate the damage incurred by the company.

In its judgment, the court of appeal upheld this legal opinion, stating the respondent had, at the very least, to have known (and, in the judgment of the Court of Appeal, knew) of the requirements for drawing the subsidy and to have known that the applicant had to comply with the condition of managing the leased land throughout the grant period without changing its acreage.

The Supreme Court, as the Court of Final Appeal, ruled that the duty of loyalty does not mean that a statutory body member would not legitimately defend interests other than those of the company. The conflict of interest regulation invokes the situation in which such interests are contrary to the interests of the company; according to the regulation, it is impossible for a member of a body to act on behalf of a company in situations in which his interests run counter to those of the company.

It is inherent to the circumstances of the present case that the aforementioned means the respondent could uphold his own interests as lessor, including the interest in receiving payment of rent, though he was not authorised – given the conflict of interest between him and the applicant – to act on the applicant's behalf in matters falling under the rental agreement. "If" the respondent "received" the written request to pay rent on behalf of the applicant and thus, too, the notice of withdrawal from the rental agreement, and failed to pass this to another company executive, he then acted on behalf of the applicant in a matter in which he was not authorised to act. Consequently, neither the call for payment of the rent due nor the withdrawal from the lease could be regarded as effectively delivered to the applicant.

Legal Update

November 2019

Nevertheless, by acting on behalf of the applicant in his own affairs (despite being unauthorised to do so) in violation of the law, and then acting as if the rental agreement had terminated as a result of contract withdrawal, though no such notification was delivered to the applicant, he caused the applicant to be compelled to return a part of the provided subsidy. The Supreme Court thus upheld the ruling of the Court of Appeal.

Shareholder and acquisition agreements – instructions to a Board of Directors regarding the management of company business

(High Court in Prague Judgment No. 14 Cmo 23/2018 of 23 January 2019)

This judgment of the High Court in Prague caused considerable turmoil throughout the legal community as it disrupted years of established and settled legal precedent and practices regarding corporate governance and acquisitions.

In this proceeding, the High Court in Prague ruled that the formulation of a shareholder agreement and a contract on the execution of voter rights based on which shareholders undertake to ensure the Board of Directors members they nominate follow their instructions in managing the business of the company (for whose violation the applicant is seeking a contractual penalty) is an invalid arrangement due to its conflict with the law, specifically § 194(4) of the Commercial Code (and analogously the currently valid treatment of § 435(3) of the Business Corporations Act), which prohibits the giving of instructions to the Board of Directors regarding business management, including the use of funds, e.g. lending.

In the present case, the applicant sought payment of a contractual penalty from the respondent for breach of the shareholder agreement under which shareholders were required to ensure that Board of Directors members nominated by them followed their instructions in managing the company.

The Court of First Instance concluded that the provisions of the shareholder agreement under which the contractual penalty claimed by the applicant had been sought by the applicant is an agreement invalid for its infringement of the law and that the applicant was not entitled to payment of that amount.

The applicant appealed the judgment. He considered the legal conclusion of the Court of First Instance to be incorrect, since the contractual arrangement did not, in his view, regulate the provision of instructions to the members of the Board of Directors, only but provided a framework for joint action by shareholders. The purpose was therefore to achieve a state where the company would naturally be managed in accordance with the will of the shareholders.

In its decision, the High Court in Prague endorsed the findings of fact and the legal assessment of the Court of First Instance and upheld its decision.

It should be noted that the judgment of the High Court in Prague is contrary to the usual practice whereby shareholder agreements normally contain a clause supported by a contractual penalty requiring shareholders to ensure that certain members of the elected bodies of a given company comply with, do or refrain from doing something. A similar concept is also applied in acquisition contracts, whereby the seller often undertakes to ensure that the company (of which it is a partner) does not take action between the signing of the acquisition contract and the settlement period of the transaction, and this obligation is usually confirmed by a contractual penalty.

Given the possible implications of the above judgment, it can be hoped that a superior court (Supreme Court of the Czech Republic) will address the issue of interference in business management – if any party to the dispute petitions for an appellate review – to clarify the interpretative practice of Czech courts in this question.

Offsetting of an employer's claim for damages against an employee

(Czech Supreme Court Judgment No. 21 Cdo 238/2019 of 21 May 2019)

In this case, the Supreme Court dealt with the unilateral offsetting of an employer's claim for damages against an employee's claim for pay. The Supreme Court concluded that an employer is entitled to set off its claim for damages against an employee's claim for wages, remuneration under an agreement or wage or salary compensation, and to withhold wages in order to satisfy its claim for damages, though only on the basis of a wage withholding agreement concluded with the employee.

In this proceeding, the applicant (employer) sought a determination of the invalidity of the immediate termination of the employment relationship to which the defendant (employee) acceded in accordance with the provisions of § 56(1)(b) of the Labour Code, as he had not been paid a part of his salary, which the applicant had unilaterally set off against a claim for damages, where the respondent did not recognise this set-off.

The Court of First Instance rejected the action as the set-off of an employer claim against an employee's wages is possible where the statutory requirements under the Labour Code and, alternatively, under the Civil Code, have been met. Since the applicant's claim for damages could not be regarded as clear or certain in the meaning of § 1987 of the Civil Code, the claim was not eligible for set-off, and so could not be set off.

The Court of Appeal agreed with the Court of First Instance opinion and upheld its decision.

The applicant filed a petition for an appellate review of the Court of Appeal's judgment, which the Supreme Court dismissed, finding that the judgment of the Court of Appeal was factually correct.

The Supreme Court stated that an employer's unilateral set-off against an employee's claim for wages, salary, remuneration under an agreement or wage or salary compensation is generally permissible subject to legal limits. However, in the case of an employer's claim for damages, the law prohibits unilateral offsetting by the employer, as the possibility of withholding wages as compensation for damage is conditional on the conclusion of a wage withholding agreement. Absent such an agreement, the employer is not authorised to withhold wages (salary, remuneration under an agreement or wage or salary compensation) as compensation for damage, even if the prerequisites of the employee's liability for the damage caused to the employer are met when the employee acknowledged his liability for and pledged to compensate the damage.