Legal Update

May 2019

Weinhold Legal

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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 trust you will find *Legal Update* to be a useful source of information. We are always interested in your opinion about our newsletter and any comments you may have regarding its content, format and frequency. Please e-mail your comments to michal.kandrac@weinholdlegal.com or fax them care of Michal Kandráč to +420 225 385 112, or simply contact your usual partner/manager.

Legislative amendments

Conflict between a trademark and a trade name

As already reported in the December 2018 issue of Legal Update, an amendment to Act No. 441/2003 Coll. on trademarks (the "TA"), which introduced significant changes to the Czech legal order, entered into effect on 1 January 2019.

In this article, we would like briefly to draw your attention to another of the changes to the TA, which is a modification of the conflict between a previously registered trademark and a trade name that was brought in line with European Union legislation by the TA amendment.

Prior to the TA amendment, the owner of an older trademark (e.g. an international trademark) valid in the Czech Republic was not entitled to prohibit the use of a Czech business name of a legal entity, if the business name was used in compliance with business practices, the principles of morality and the rules of competition. However, the TA no longer mentions this defence, and so, from 1 January 2019, it is possible under the TA for the owner of a trademark valid on the territory of the Czech Republic to prevent the use of a later registered identical/similar trade name of a legal entity whose business is identical/similar to the products and services for which the trademark was registered.

In this respect, we recommend that partners and executive bodies of commercial firms take note of the above and always review the appropriate trademark lists before choosing/changing a trade name. Otherwise, the risk that the proprietor of a previously registered trademark could exercise their rights against the company, rights such as the entitlement to insist a trade name be changed, entitlement to compensation of damage, reasonable satisfaction etc., cannot be ruled out.

Recent case law

Profit of a joint-stock company may be distributed based on financial statements older than six months

(Czech Supreme Court Judgment No. 27 Cdo 3885/2017 of 27 March 2019)

In the above-mentioned decision, the Supreme Court of the Czech Republic ("Supreme Court") commented on certain contentious issues concerning the formalities of an invitation to a General Meeting and the distribution of profits in a joint-stock company.

In this case, the Supreme Court dealt with a situation in which the applicants (shareholders of the company) asked the general courts to declare invalid a General Meeting resolution on the distribution of profit. The applicants based their claim mainly on the failure to satisfy the legally required content of the invitation to the General Meeting, as well as on the illegality of the decision on the distribution of profit itself.

They based their arguments primarily on the fact that the written invitation to the General Meeting did not properly justify the Board of Directors decision in question, but merely referred to documents available on the company's website. They further argued that the allocation of funds to a joint-stock company must be treated similarly to the distribution of profits in the form of directors' fees (i.e. the distribution of profit between the executive and supervisory bodies); therefore, it is not possible to allocate the company's profits to funds created by an act of the founders without a concurrent decision to pay shareholder profits. Since the courts of lower instance rejected the petition seeking nullification of the General Meeting resolution, the applicants lodged an appeal against the appellate court decision, which the Supreme Court found justified. The Supreme Court first dealt with the issue of the content of the invitation to the General Meeting, concluding that a joint-stock

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company may publish the invitation in its entirety only on its website, provided that it duly refers to these larger sections in an abbreviated written invitation. Since the internet invitation in the present case did not contain any additional rationale as compared to the written invitation, but only the mentioned documents, the Supreme Court in this respect agreed with the applicants.

In addition, the Supreme Court referred in the appellate review to the issue of the distribution of profits within a joint-stock company. Firstly, the Supreme Court cited its earlier case law according to which it was not possible to use duly prepared financial statements for the previous fiscal year as a basis for distributing profit after the expiry of the deadline set for convening the General Meeting to discuss the ordinary financial statements (six months from the last day of the fiscal period). However, according to the Supreme Court, this conclusion no longer applies as Act. No. 90/2012 Coll. on commercial companies and cooperatives (the "CCCA") contains a so-called insolvency test, which prohibits the payment of profits and funds from other own resources (and advances on them) if this would cause company bankruptcy. It is the view of the Supreme Court that the insolvency test provides adequate protection to creditors against the unlawful discharge of company resources; therefore, as of the effective date of the CCCA, the financial statements prepared for the previous fiscal year may serve as a basis for distributing profit until the end of the following fiscal year.

In the decision, the Supreme Court also commented on the issue of distributing profits to funds of joint-stock companies. The Supreme Court concluded in this case that a joint-stock company need not distribute profit among shareholders solely on the basis of important reasons, which may include, for example, provisions of the Articles of Association on the distribution of profits, while respecting the prohibition of abuse of a voting majority. According to the Supreme Court, these rules will apply similarly to the distribution of profits to funds set up by a legal act of the company founders. Given that in the present case the Articles of Association addressed the distribution of profits to the social fund, the Supreme Court considered this to be a serious reason and did not agree with the applicants.

As a result of an error of law on the part of the lower instance courts, the Supreme Court annulled the contested decision and, in its appellate review, referred the case back to the Court of First Instance for a new decision.

We are of the opinion that the cited decision not only provides new possibilities regarding the disposition of the equity of joint stock companies, but also an increased standard of care of executive and supervisory bodies in the distribution and disbursement of profits, as the statutory body of the company is responsible for compliance with the insolvency test and other rules. In the context of the above-mentioned and the precedent nature of this decision, it can also be expected that the conclusions of the Supreme Court will influence existing corporate practice.

Contractual penalty proportionality in a non-compete clause under the Labour Code

(Czech Constitutional Court Judgment No. II. ÚS 3101/18 of 2 May 2019)

In the above judgment, the Constitutional Court of the Czech Republic ("Constitutional Court") dealt with the constitutional-law aspects of a non-compete clause agreed in an employment contract.

Specifically, it was a situation in which the complainant (a commercial company) was seeking payment from a secondary participant – a former worker (the defendant in proceedings before the general courts) – of a contractual penalty of CZK 420,000 for breach of a non-compete clause that had been agreed by the litigants in an employment contract.

At the heart of the dispute was the fact that the secondary participant had concluded a contract of employment with the complainant's competitor on the basis of which she had worked four working days while the non-compete clause was still in effect. According to the complainant, the secondary participant thus breached the obligation to refrain from pursuing a gainful activity with a subject in competition with the complainant's business for one year after the termination of her employment, thereby entitling the complainant to a contractual penalty of CZK 420,000 per year.

The Court of First Instance disagreed with the complainant's opinion, and, with regard to the short period of employment of the secondary participant, only awarded the complainant an amount of CZK 35,000. The complainant appealed this decision, and in the appeal proceedings against the decision of the first instance the appellate court awarded the complainant the sum of 385,000 CZK. The appellate court did so by referring to the fact that the secondary participant was entitled to a remuneration in the amount of the average monthly earnings for each month for the duration of the non-compete clause, and therefore it was a valid non-compete clause that could not be moderated. The secondary participant sought an appellate review of this decision in which the Supreme Court concluded that the subject non-compete clause was indeed valid, complete and correct. Notwithstanding, the Supreme Court ruled that the enforcement of this contractual penalty would be contrary to good morals in view of the negligible breach of the obligation, and rejected the complainant's claim in full.

The complainant lodged a constitutional complaint against this Supreme Court decision, primarily arguing in the complaint that the Supreme Court unconstitutionally interpreted the meaning of the non-compete clause and, by not granting the agreed contractual penalty, interfered with the complainant's right to free enterprise. The Constitutional Court found the constitutional complaint justified, agreeing with the complainant's arguments and emphasizing that the general courts are obliged to provide protection to business activities if the violation of a non-compete clause agreed in an employment contract would, even potentially, favour the competition. The Constitutional Court further noted that one purpose of the non-compete clause is to protect the employer from leakage of business secrets and other relevant information to a competitor enterprise, and therefore the duration of the non-compete clause is irrelevant to the incurring of the contractual penalty, as the conveyance of sensitive information and know-how can occur in a matter of minutes.

Since, according to the Constitutional Court, the contractual penalty amounted to a reasonable sanction for non-compliance with the non-compete clause, it found in favour of the complainant, annulled the contested decision and returned it to the Supreme Court.

We agree with the foregoing Constitutional Court decision. In our opinion, the trivialization and differentiation of the type and degree of breach of contractual obligations could significantly interfere with the legal certainty and legitimate expectations of employers, as a result of which institutes such as the non-compete clause or the contractual penalty would become meaningless.