Legal update

February 2023

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The information contained in this bulletin is presented to the best of our knowledge and belief at the time of going to press. However, specific information related to the topics listed in this bulletin should be consulted before any decisions are made.

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Daniel Weinhold, Václav Štraser, Ondřej Tejnský

ESG – environment, social, (corporate) governance:
Tereza Hošková

Mergers and acquisitions:
Daniel Weinhold, Václav Štraser

Insolvency and Restructuring:
Zbyšek Kordač, Jakub Nedoma

IT, media, telekomunikace:
Martin Lukáš, Jakub Nedoma, Michal Przeczek

Real estate:
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Personal Data Protection:
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Labour law: Eva Procházková, Anna Bartůňková, Daša Aradská, Ondřej Tejnský

Slovak law:
Tomáš Čermák, Karin Konečná

Family property administration:
Milan Polák, Zbyšek Kordač, Michaela Koblasová

Dispute resolution: Milan Polák, Zbyšek Kordač, Anna Bartůňková, Michaela Koblasová, Michal Švec

Competition law / EU law:
Tomáš Čermák

Start-ups and Venture Capital & Cryptocurrencies:
Pav Younis, Martin Lukáš, Jakub Nedoma, Michal Švec, Ondřej Tejnský

Public procurement & Public sector:
Martin Lukáš, Tereza Hošková, Monika Švaříčková

Order of fulfillment of monetary debt

The Chamber of Deputies will discuss a proposal to amend § 1932 of Act No. 89/2012 Coll., the Civil Code ("Civil Code"), which regulates the order of fulfillment of the principal of the debt and its accessories. Under the current regulation, the debtor pays first for the costs already determined, then for the default interest for delay, then for the interest, and finally for the principal, unless the debtor expresses a different intention and the creditor agrees to this. Paragraph 2 of that provision regulates the order of fulfillment of a monetary debt where the debtor is a consumer, in which case the debtor pays first on the principal and then on the ancillaries of the claim.

The group of deputies now tries to amend the provision in question so that the regulation now applying only to consumers would be applied in all cases of fulfillment of a monetary debt, i.e., all payments made by debtors would be credited first to the principal and then to the ancillaries of the claim, without the debtor having to make any declaration and without the creditor having to agree with it. In this way, the debtor's position in the contractual relationship is stronger, so that he can, even without the creditor's intention and consent, fulfil the principal of the debt in priority. According to their argument, under the current regulation, debtors get into a debt spiral from which it is difficult to escape. As a result, the State pays for the recovery of the debt and is responsible for the costs of falling into and out of the debt trap. The new regulation would help to mitigate the effects of non-standard behaviour and contractual terms that are one-sided and beneficial only to creditors.

The explanatory memorandum points out that the proposal is not likely to cause problems in normal economic life and will not have a negative impact on various contractual relationships. It can be argued that the amendment would undoubtedly affect at least the accounting practices of creditors, but deputies do not see this as a complication, as they believe that a sufficient period (6 months) has been set for the amendment to take effect. Regardless of the new regulation, the principle that the parties to the contract (creditor and debtor) are able to agree on a different order in the contract than the amendment provides for remains valid.

Case law

Assessment of legal presumptions and fictions used in contracts

(Judgment of the Supreme Court of the Czech Republic file no. 23 Cdo 1001/2021 of 23 March 2022)

Presumptions (formulated in contracts by the expressions *"it is presumed"* and *"it is conclusively presumed that"*) and fictions (formulated in contracts by the expressions *"it is considered"*) are commonly used in contracts to cover the facts which are presumed to exist. These are typically provisions for the delivery of the work, rejection of the work, delivery of documents or payment of the purchase price. Where presumptions and fictions are used, the party invoking them does not have to prove the relevant facts, but only refer to the provisions set out in the contract.

Before the judgment of the Supreme Court of the Czech Republic of 23 March 2022, file no. 23 Cdo 1001/2021, the Supreme Court of the Czech Republic had a more negative attitude to the application of the presumption of fictions in contracts, as in its opinion these institutes could only be set out by law and it was not at the parties' disposal to arrange them. However, in light of the recodification of the Civil Code, which,

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among other things, extended the autonomy of the parties' intent, and criticism from the professional community, the Supreme Court of the Czech Republic reconsidered its previous conclusions and judged that the use of presumptions and fictions in contracts is not necessarily invalid

In the decision in question, the Supreme Court of the Czech Republic resolved a dispute between the contractor and the client arising from a work contract in which the parties, both business entities, agreed, among other things, that

"the work is considered to have been handed over if the client fails to attend the acceptance of the work without any reason and repeatedly (at least twice)".

The Supreme Court of the Czech Republic concluded that:

"The legal regulation of the handover of the work does not contain a direct express prohibition of a different arrangement. The question of the assessment of a possible indirect prohibition has to be considered in the light of the above-mentioned meaning as well as the purpose of the regulation in question. However, the meaning and purpose of the legal regulation do not (in itself) restrict the parties from agreeing autonomously on special conditions for the handover of the work that are relevant to their contractual obligation, e.g. a special written form, special circumstances in relation to the handover report, the question of the circumstances of the possible right to refuse to accept the work or the obligation to accept the work if the work suffers from certain defects, etc. However, the specific circumstances of such an arrangement must always be considered.

Under the circumstances of the case in question, the Court of Appeal does not find any reasons which could invalidate the arrangement in question. The acceptance of the work is generally a dispositive provision. In the case under consideration, it cannot be concluded from the courts' findings of facts that the parties, as two business entities, were in an imbalanced position, i.e. there was no legal consideration from the point of view of the protection of the weaker party (the business entity pursuant to § 433 of the Civil Code or the consumer pursuant to § 1810 et seq. of the Civil Code).

It can be summarized that if the parties of a contract use verbal expressions that usually express legal presumptions or legal fictions in law (e.g. "it is presumed", "it is conclusively presumed that", "it is considered") to express a certain consequence they foresee, that contractual arrangement is not invalid for that reason only.

In deciding whether such an arrangement is in conflict with a statutory provision or is against good manners, it is necessary to examine in each individual case what the content of the arrangement is. At the same time, it is also necessary to consider the position of the parties in which they entered into the arrangement, whether it is a balanced relationship between the parties, e.g., business entities, or whether it is a relationship between an business entity on one side and a weaker party on the other side, i.e. a consumer or a business entity of the weaker party.

An agreement between two business entities during their business activity that "the work is considered to have been handed over if the ordering party unreasonably and repeatedly (at least twice) does not attend the acceptance of the work", aimed at the contractual regulation of the conditions for handing over the work as one of the prerequisites for the contractor's right to payment of the price of the work, is not prohibited by the Civil Code by itself, and is not against good manners."

The Supreme Court has therefore judged that presumptions and fictions in contractual relations cannot be considered invalid without any further consideration if (i) they are not in conflict with mandatory provisions, (ii) they are not against good manners and (iii) the parties are in the same position.

New concept of moderation of contractual penalties

(Judgment of the Supreme Court of the Czech Republic file no. 31 Cdo 2273/2022 of 11 January 2023)

In the decision of the Supreme Court of the Czech Republic of 11 January 2023, file no. 31 Cdo 2273/2022, the plaintiff claimed that the defendant should be ordered to pay her a contractual penalty of CZK 250,000 together with statutory interest for delay. The court of first instance dismissed her action, the plaintiff appealed and the court of appeal upheld her action in full. The defendant appealed against the judgment of the court of appeal because the court of appeal differed from the established decision-making practice of the Court of Appeal in considering the question of the "proportionality of the contractual penalty and its moderation". The Supreme Court of the Czech Republic decided to deal with this case through the Grand Chamber of the Civil and Commercial Chamber.

The Supreme Court of the Czech Republic has expressed its opinion on the modulation of contractual penalties many times before, and has come to the conclusion that when considering the validity of contractual penalty arrangements, it is necessary to consider the functions of contractual penalties (preventive, reimbursement and punitive). The proportionality of the agreed amount of the contractual penalty had to be considered in the light of the overall circumstances of the act, its motives and the aim pursued. It was also necessary to take into account the amount of the sum secured, from which it could also be concluded that the contractual penalty was excessive in the light of the relative proportion of the original and the sanctioning obligation.

The main principle for the moderation of the contractual penalty of the old regulation was therefore the disproportionality of the contractual penalty arrangement, not the disproportionality of the specific claim which resulted from the arrangement. However, in the case of a finding that the contractual penalty arrangement was excessive, the final amount of the contractual penalty was moderated, not the method of determining it.

The Supreme Court of the Czech Republic has now established that the proportionality of a contractual penalty should be considered not only with regard to the manner and

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circumstances in which it was agreed, but also the circumstances at the time of the breach of contractual obligations:

"Since the examination of the proportionality of a contractual penalty (of a specific claim) and its further moderation to a proportional amount necessarily requires a balancing of the specific interests of the debtor and the creditor in a particular breach of a contractual obligation, not only the circumstances known at the time of negotiation of the contractual penalty will play a role in the proportionality evaluation (the criteria of the value and importance of the secured obligation may also apply, but this may change after the contractual penalty has been negotiated), but also the circumstances that existed at the time of the breach of the contractual obligation, as well as the circumstances that occurred after the breach, if they clearly had an origin in the breach of the contractual obligation (e.g. additional damage) and if they were foreseeable at the time of the breach of duty. If it is not clear how and in what circumstances the breach of the contractual obligation occurred and to how much the creditor's interests were affected, the question of the proportionality of the contractual penalty claim cannot be answered. Moderation may be applied only where there are no doubts about the excessive character of the contractual penalty claim, since only then is judicial intervention in the creditor's claim (i.e. in the property right protected by Article 11 of the Charter of Fundamental Rights and Freedoms) justified."

Thus, the Supreme Court has newly decided that the modification of the contractual penalty can be divided into the following stages (steps): In the first step, the court applies the rules of interpretation set out in § 555 et seq. Civil Code, and identify what function the contractual penalty was supposed to perform. The court will also take into account all the circumstances of the particular case - not only the circumstances already known at the time the contractual penalty was agreed upon, but also the circumstances that were present at the time of the breach of the contractual obligation, as well as circumstances that occur later if they have their origin in the breach of the contractual obligation itself. On the basis of those circumstances, the court decides whether the amount of the contractual penalty is proportionate in relation to the creditor's interests which were harmed by the breach of the contractual obligation and should have been protected by the contractual penalty. If the court concludes in the previous step that the contractual penalty is not disproportionate, or if it is unable to clarify the extent of the consequences of the breach of the contractual obligation for the creditor on the basis of the evidence taken, in order to reach a legal conclusion on the disproportionality of the contractual penalty claim, the court cannot reduce the creditor's claim for contractual penalty. Otherwise, the court will in the third step reduce the contractual penalty to a proportionate amount (fair in concreto) taking into account the functions it is supposed to perform and the value and importance of the obligation secured. At the same time, the court is limited to the amount of the damage caused up to the time of the decision by the breach of the obligation to which the contractual penalty relates.

Therefore, the Supreme Court concluded that the new concept of moderation of contractual penalties under § 2051 of the Civil Code cannot (in contrast to the previous concept) be conceived as an instrument of control of the proportionality of the agreement. On the other hand, its basis becomes the examination of the proportionality of a specific claim for a contractual penalty and its aim is to ensure that the creditor is not paid a contractual penalty that is *in concreto* disproportionate with regard to the specific interests of the parties. The conclusion about whether a contractual penalty is excessive is left by the law-maker to the discretion of the court, based on an assessment of the individual circumstances of the particular case, which the court finds legally relevant. The law only requires taking into account during the subsequent moderation the value and importance of the secured obligation and limits the possibility of reducing the contractual penalty to the amount of the damage incurred until the time of the decision from the breach of the obligation to which the contractual penalty relates.

Please send your comments to: **Jan.Smital@weinholdlegal.com** or contact the person you are usually in touch with. To unsubscribe from publications: office@weinholdlegal.com