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# THE MERGERS & ACQUISITIONS REVIEW

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SEVENTH EDITION

EDITORS

SIMON ROBINSON AND MARK ZERDIN

LAW BUSINESS RESEARCH

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## Chapter 21

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# CZECH REPUBLIC

*Lukáš Ševčík, Jitka Logesová and Bohdana Pražská<sup>1</sup>*

### I OVERVIEW OF M&A ACTIVITY

The available numbers on M&A activity in the Czech Republic give an inconsistent picture of the market. While some reports claim that the number of transactions and the total transaction value has risen in 2012 against the year 2011,<sup>2</sup> others report that the Czech M&A market has contracted for the third consecutive year both in transaction volume and value.<sup>3</sup> On the basis of our own observation we believe that the market was somewhere in between – that is to say, rather stagnant. This would be supported by the general trend of M&A activity in emerging Europe, which is unanimously reported as having shown a more or less downward development<sup>4</sup> and also by the fact that the Czech economy was going through a recession in 2012.

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2 Ernst & Young's Central and South Eastern Europe – M&A Barometer 2012 records 155 M&A transactions for the Czech Republic in 2012, compared to 120 deals in 2011 and estimates total transaction value to rise from around US\$6 billion to US\$8.3 billion.

3 Deal Watch's Emerging Europe M&A Report 2012 records 102 transactions with a total value of €1.3 billion in 2012, compared to 153 transactions and a value of €1.556 billion in 2011.

4 Ernst & Young's Central and South Eastern Europe – M&A Barometer 2012 (reporting on Bulgaria, Croatia, Czech Republic, Greece, Hungary, Poland, Romania, Serbia, Slovakia, Slovenia and Turkey) saw the number of transactions in the region decline by 1.8 per cent from 1,128 in 2011 to 1,108 in 2012; Deal Watch's Emerging Europe M&A Report 2012 (reporting on Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine) reports a 40 per cent decrease in the number of transactions (from 3,792 in 2011 to 2,265 in 2012) and a decline in total transaction value

Despite this, within emerging Europe the Czech market has secured a position in the highest quartile, with only Russia, Turkey, Ukraine and Poland ahead of it as far as M&A activity is concerned.<sup>5</sup>

In 2012 the Czech M&A market was, in line with the regional trend, dominated by domestic transactions<sup>6</sup> – this is mainly a result of the decreased attractiveness of Czech targets for foreign and financial investors.<sup>7</sup> This might be because the Czech market has further matured, having placed itself uncomfortably between the hotter emerging markets (offering higher returns) on one side and the more secure, established markets on the other side. However, the good thing about this is that the Czech M&A market is starting to show at least some degree of the internal maturity that comes with the ability to generate transactions from within the market, without the necessity of being predominantly fuelled by FDI. The view of the Czech market as having become more mature is also supported by the increase in the outbound investment of Czech buyers, which accounted for some very significant transactions in both emerging markets and developed markets such as Germany. This, together with what we hope is the restored appetite of financial investors and the upturn in the domestic economy should make for a healthier Czech M&A market in 2013.

## **II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A**

M&A activity in the Czech Republic is governed by:

- a* Act No. 513/1991 Coll., the Commercial Code, as amended, which sets out general corporate law rules applicable to all types of companies, contract law rules applicable to business transactions, and squeeze-out rules.
- b* Act No. 104/2008 Coll., the Takeover Bids Act, as amended, which regulates mandatory takeovers, voluntary takeovers and implements Directive 2004/25/ES on Takeover Bids.
- c* Act No. 125/2008 Coll., on Transformations of Companies and Cooperatives, as amended, which contains rules on mergers, cross-border mergers, transfers of business and other company transformations.

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from €150 billion to €121 billion; Mergermarket's M&A roundup for 2012 also shows a decline in the number and value of deals for the European market.

5 Ernst & Young's Central and South Eastern Europe – M&A Barometer 2012 and Deal Watch's Emerging Europe M&A Report 2012.

6 According to Ernst & Young's Central and South Eastern Europe – M&A Barometer 2012, domestic transactions accounted for 61 per cent of transactions in CZ (53 per cent in the region); 12 per cent were outbound (10 per cent in the region) and 27 per cent were inbound (37 in the region).

7 Ernst & Young's Central and South Eastern Europe – M&A Barometer 2012: only some 20 per cent of the transactions were closed by financial investors and only 27 per cent of transactions were inbound (FDI), with the USA being the most important FDI investor (eight deals), followed by Germany (five deals).

- d* Act No. 256/2004 Coll., on Capital Markets, which contains the regulation of insider dealing, market manipulation, reporting duties in relation to the acquisition of voting rights in publicly traded companies and the public offering of securities.
- e* Act No. 21/1992 Coll., on Banks, as amended, which contains the rules applicable to the acquisition of shares issued by banks.
- f* Act No. 591/1992 Coll., on Securities, which contains general provisions regulating the issue and transfer of securities.
- g* Act No. 219/1995 Coll., the Foreign Exchange Act, as amended, which contains the rules applicable to dealings with foreign currency and sets out reporting duties for legal entities that have their seat in the Czech Republic and foreign entities doing business in the Czech Republic.
- h* Act No. 15/1998 Coll., on the Supervision of Capital Markets, as amended, which sets out the powers of the CNB.
- i* Act No. 143/2001 Coll., on Protection of Economic Competition (the Competition Act), which sets out competition law and merger control rules.
- j* Act No. 418/2011 Coll. on Criminal Liability of Legal Entities (ACLLE).

From 1 January 2012, the Czech Republic joined the increasing number of countries that criminally prosecute legal entities. The new concept of the criminal liability of legal entities simplifies the prosecution of crimes in cases when it is not possible to prosecute a specific individual but it is obvious that the crime was committed for the benefit of a legal entity. Certain acts committed by individuals can be attributed directly to a legal entity. Such legal entity then has the chance to exonerate itself by proving that it had put in place adequate procedures to prevent illegal acts being committed by any of its employees. ACLLE has a significant extraterritorial effect. It is therefore possible that a Czech legal entity that has engaged in corruption abroad or in the Czech Republic and that carries on business activity in (for example) the United Kingdom could be prosecuted under ACLLE as well as under foreign anti-corruption legislation (e.g., the United States' FCPA or the UK Bribery Act).

### **III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT**

A new act prohibiting certificated bearer shares that have not been immobilised or converted to book-entered shares became effective on 30 June 2013. The act stipulates that all certificated bearer shares that have not been immobilised or converted to book-entered shares will be converted by operation of law to certificated registered shares on 1 January 2014.

In addition, the new law will stipulate that all payments (such as dividend payouts) made by the company to the owner of the registered certificated shares will have to be made by bank transfer. Shareholders holding certificated registered shares will be required to notify to the company a bank account number for the purposes of such payments.

The board of directors will be required to amend the articles of association and to file an application for the registration of the change of the form of shares with the Commercial Register by 30 June 2014.

Shareholders will be required to exchange their shares and provide the company with their bank details by 30 June 2014.

A failure of the shareholders to comply with the new requirements will result in the suspension of their shareholder's rights. In addition, if a company approves the distribution of a dividend when a shareholder is in default with the duties described above, such shareholder will not be entitled to receive such dividend (even when it later complies with these duties).

#### **IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS**

Although there were fewer foreign inbound deals compared to domestic deals (61 per cent domestic), overall FDI into the Czech Republic has significantly risen in 2012 compared to 2011 and amounted to more than €8 billion (as compared to €1.7 billion in 2011). As far as acquisitions are concerned, the origin of foreign capital invested in the Czech Republic is dominated by western European and non-European investors, who continued to lead against CSE countries in 2012. The USA was the most active in 2012 (closing eight deals in the Czech Republic), followed by Germany (five).<sup>8</sup> For FDI in total the country ranking shows the Netherlands first, followed by Germany, Austria, the United States, South Korea and Switzerland.<sup>9</sup>

#### **V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES**

The most significant transactions in 2012 were the acquisition by EPH of 49 per cent of Slovak energy company SPP for €2.77 billion, Molson Coors' acquisition of Starbev from CVC (which included Staropramen brewery, a major Czech asset) for €2.65 billion, and the sale by PPF of 26.5 per cent of shares in the Russian Nomos bank for more than €500 million – all of them transactions that, despite involving Czech players or assets, more or less took place 'outside' the Czech Republic.

On the more domestic end of the market, the most significant transactions included the acquisition of Energotrans by CEZ from EPH for more than €500 million, the acquisition of the remaining 50 per cent in the Sazka betting and lottery business by KKCG from PPF for reportedly around €140 million, and the acquisition by EPH from CEZ of Germany's MIBRAG (coal mining) and the acquisition by Penta of the Lloyd's and Gehe Pharma pharmacies for €85 million.

Significant acquisitions by foreign players include the acquisition by MIH Allegro (a subsidiary of Naspers) of 77.5 per cent of shares in Netretail Holding (which operates the Mall.cz online shopping website) from Intel Capital and MCI Management for US\$220 million, the acquisition by MEP of the Alpha Medical laboratories business from Penta for reportedly over €100 million, and the acquisition by Gazprombank of 46 per cent in Eriel Group (drill and well equipment) for US\$127 million.

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8 Ernst & Young's Central and South Eastern Europe – M&A Barometer 2012

9 Czech Invest's Fact Sheet – Inflow of Foreign Direct Investment.

Transactions with undisclosed value by foreign investors include the acquisition by Hungary's oil and gas company MOL of Pap Oil and Bohemia Realty Company (the operator of a network of 124 petrol stations) and German retail group REWE's acquisition of a 51 per cent stake in Exim Tours (a travel agency) from TUI Travel.

As far as real estate transactions (mostly concluded in the form of share deals in the Czech Republic) are concerned, the most important ones were the sale of the City Tower by J&T to Proxy Finance for €130 million, L88's acquisition of the Radio Free Europe building from ORCO for €93 million and the acquisition by Germany's DEKA Immobilien from Skanska of the City Green Court for €54 million.

The services industry was the most active target industry (by number of transactions) in the Czech Republic,<sup>10</sup> with the manufacturing and energy sectors also very strong. The life sciences sector has seen a buoyant year<sup>11</sup> and also the real estate market was significantly up in 2012.

The sectors that are considered to continue to show most M&A activity are energy (with the known targets being Net4Gas, the Detmarovice power plant, and certain assets of Alpiq), health care, consumer products, IT and media, and machinery and real estate (with CPI and CTP again being expected to be the most active local players). At a more regional level, there is still room for financial sector consolidation, which could include a larger transaction in the banking sector, as well as minor transactions in the insurance and consumer credit business. In that context, Generali in early 2013 exercised its option to acquire in two stages by the end of 2014 all of PPF's 49 per cent stake in Generali PPF for €2.521 billion.

## VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Although Czech banks have remained strong and were not hit by the economic situation in Europe, their ability to lend money has been restricted by the problems faced by their foreign parent banks. As a result, the willingness of Czech banks to lend money has decreased in general. Parent banks are more closely supervising the lending activity of their Czech subsidiaries. A number of large development projects were not completed due to the financial difficulties being suffered by developers; in addition, development financing was almost not available at all. On the other hand, export financing seems to be increasing.

See Sections V and X, *infra*, for a description of private equity activities in the Czech Republic.

## VII EMPLOYMENT LAW

The Czech Labour Code has been amended as of 1 January 2012 in order to strengthen the contractual autonomy of the employer and the employee as the contractual parties and also in order to bring more flexibility to the employment relationship. The

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10 Ernst & Young's Central and South Eastern Europe – M&A Barometer 2012.

11 Deal Watch's Emerging Europe M&A Report 2012.

employment relationship now reflects more closely the business and economic needs of employers in respect of certain aspects, which could help them to adjust their businesses to meet changing market demands. On the other hand, selected employees' rights are now protected more intensively than they were before 1 January 2012.

The Labour Code allows a trial period of up to six months for managers. Within the trial period, both the employer and the employee can terminate the employment relationship without reason and with immediate effect. In the case of other 'ordinary' employees, a trial period of only a maximum of three months is possible.

Czech law generally prohibits (with some exceptions) an employee of a company holding a place on the statutory body of the same company. The Czech Commercial Code now allows, under certain limited conditions, the existence of an employment relationship (e.g., as financial director) and membership in the statutory body of the same company (e.g., as an executive director). Although the provision of the Czech Labour Code cannot be applied retroactively (and thus, it cannot remedy any defects in an employment relationship that arose in the past), this change is significant for the future regulation of companies in which one person concurrently sits on the executive body of a company and also has an employment contract covering a specific portion of responsibilities of the statutory body. As of 1 January 2014, the Czech civil law system as a whole will be materially changed, which will also have a limited impact on some employment issues. New Act No. 90/2012 Coll., on Commercial Companies and Cooperatives, which will come into effect on 1 January 2014, shall be more flexible in terms of the regulation of a coexisting employment relationship and membership in the statutory body of the same company.

Regarding the transfer of employees within the transfer of an employer's business or undertakings (or parts thereof) to another entity, employees' position and their rights related to the transfer became more protected under the Labour Code. The respective Czech legal regulation under the Labour Code generally reflects the Acquired Rights Directive (2001/23/EC), with a few adjustments to reflect Czech law. If an employee gives notice within two months of the transfer, he or she can claim in court that the employment relationship was terminated on the grounds that considerable impairment of working conditions was caused by the transfer and claim a severance payment. Termination of an employment contract solely on the basis of the transfer of the business of the employer to another entity is not allowed under Czech law through implemented European legal regulation.

The calculation of severance pay in the case of notice given by the employer that is dissolved, moves or undergoes organisational changes is now less standardised. Severance payment is now graded by the length of the employment in the following manner:

- a* if the employment relationship is less than one year old, the severance pay will amount to one month's average salary;
- b* if the employment relationship is between one and two years old, the severance pay will correspond to two times the employee's average salary; and
- c* if the employment relationship is two or more years old, the severance pay will amount to three times the employee's average monthly salary.

At least 30 days prior to the transfer, both the employers (i.e., the transferor and the transferee), shall provide the trade union or work council or (if neither has been established within the employer) directly the employees with certain information stipulated in the

Labour Code (e.g., the date of the transfer, the reasons for the transfer and the measures that will be carried out in relation to the transfer).

Also, regulation of non-competition clauses has changed slightly and the amount of remuneration payable to an employee now amounts to one half of his or her average monthly earnings payable to the employee every month of the non-competition period.

## **VIII TAX LAW**

No recent relevant amendments or modifications to Czech tax regulations affecting mergers or acquisitions, or both, have been issued. There is a proposal that suggests that a contribution of real estate to the subsidiary will not be exempt as of 2014.

Czech tax residents (companies with their seat or place of management in the Czech Republic) are taxed on their worldwide income. Non-Czech tax residents are taxed only on their income from Czech sources (e.g., dividends, interest, royalties, permanent establishment income) while respecting the provisions of applicable double taxation treaties.

The taxable base is the profit (or loss) figure reported according to the Czech Accounting Standards, which is adjusted for non-deductible expenses and non-taxable income, as set out in the Czech Income Taxes Act.

Applicable taxes include income tax, VAT, excise duties, energy tax, gift tax, inheritance tax and real estate transfer tax, real estate tax and road tax. There is a proposal suggesting that gift tax and inheritance tax be included in corporate tax as of 2014.

The Income Tax Act establishes a rate of withholding tax on dividends and interests and similar distributions of earnings and interests or other financial payments of 15 per cent. Royalties are subject to a 15 per cent withholding tax. In certain cases 35 per cent withholding tax may apply on distribution of income to a non-treaty taxpayer.

Certain exemptions are granted under EU directives that have been implemented into Czech tax legislation. The withholding tax can also be reduced or eliminated on the basis of double taxation treaties.

## **IX COMPETITION LAW**

There have not been any recent legislative amendments relevant to mergers and acquisitions.

The merger control regime is set out in the Competition Act. It is enforced by the Office for the Protection of Competition (the Office). For mergers with a European Union dimension, EU merger rules would apply and the European Commission would be the competent authority.

Filing is mandatory if the transaction presents a concentration in the meaning of the Czech merger control rules and the turnover thresholds have been fulfilled. It is possible to make a 'simplified' merger notification in the event that the transaction would have a small impact on the relevant markets. There is no specific deadline for making a filing, but the transaction must be filed and clearance obtained prior to implementation.

The standard statutory deadline for the issuance of a decision by the Office is 30 calendar days from the date of the filing of a complete notification. In the event of simplified

proceedings, the deadline is 20 days. In the event of an in-depth investigation, the statutory deadline is five calendar months from the date of the filing of a complete notification.

If the Office finds that a concentration has the potential to impede effective competition, it may block it or alternatively accept remedies. The Office basically accepts only structural remedies. In the past, there have been only a few decisions where the Office has blocked a concentration and there are a few clearance decisions with remedies every year.

As a result of the economic crisis, the Office has publicly declared its willingness to apply the concept of the 'failing firm defence', which is basically in line with the principles applied by the European Commission. The Office has also shown its willingness to grant an exemption from the prohibition on the implementation of a concentration before the Office has given its approval if necessary. None of these rules have been applied by the Office in relation to the undertakings affected by the economic crisis so far.

## X OUTLOOK

### i M&A market

2013 has seen a good start with the sale of Net4Gas gas transmission grid by RWE to Allianz and Borealis, but it remains to be seen if this has kick-started M&A activity. Expectations within the market is for a modest increase at best, which will be heavily dependent on an improvement in both the domestic and global economy.

### ii New private law

The Czech Republic is to have a completely new system of private law.

The new Civil Code and the new Business Corporations Act will become effective from 1 January 2014.

The new laws draw their inspiration from the pre-World War II legal tradition and the Austrian, French, German, Italian, Quebec and Swiss civil codes. The new laws will completely change the Czech legal landscape and bring about, *inter alia*, the following revolutionary changes:

- a* the reasons for the invalidity of contracts will be significantly limited. In most cases, even if there is reason for a contract to be declared invalid, it will be declared invalid only if a party to the agreement challenges it, otherwise it will be deemed to be valid;
- b* the concept of a 'trust' as an organisational separation of property that does not lead to the establishment of a separate legal entity will be recognised;
- c* the dual regulation of contracts and obligations currently contained in both the Civil Code and the Commercial Code will be eliminated and unified; and
- d* Section 196a of the Commercial Code, governing the terms under which transactions between related parties may be carried out, and which is one of the most common reasons for the invalidity of contracts under Czech law, will be cancelled.

Many of the described changes should have a positive effect on M&A activities in the Czech Republic.

## Appendix 1

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# ABOUT THE AUTHORS

### **LUKÁŠ ŠEVČÍK**

*Kinstellar s.r.o., advokátní kancelář*

Lukáš Ševčík is the managing partner of Kinstellar's Prague office and co-head of the firm's corporate/M&A practice, specialising in the area of M&A and corporate finance. He is a German-qualified lawyer (1992) and member of the German and Czech bars. Mr Ševčík has 20 years' experience in advising international clients on their investments and divestitures in emerging Europe. Prior to coming to Prague in the mid-1990s, he had gained experience in Frankfurt, Munich and Toronto. He was an associate and a partner with Nörr Stiefenhofer Lutz (1995 to 2001) and a partner with Linklaters (2002 to 2008). In the past 15 years Mr Ševčík has advised international clients on more than 200 M&A transactions including privatisations, private equity transactions, joint ventures, reorganisations and cross-border M&A transactions, covering a broad spectrum of industry sectors and deal sizes, including large-scale privatisations, PE transactions and private acquisitions. He also has significant experience in acquisition financing, both on straight bank debt as well as capital markets. Mr Ševčík is also chairman of the board of directors of the British Chamber of Commerce in Prague. He speaks German, English and Czech.

### **JITKA LOGESOVÁ**

*Kinstellar s.r.o., advokátní kancelář*

Jitka Logesová is a partner at Kinstellar's Prague office and co-head of the firm's private equity practice. She specialises in corporate law, in particular M&A and private equity. Her experience includes advising, for example, JP Morgan Partners and Bancroft II on the acquisition of Nowaco Group's production and distribution activities in the Czech Republic, Slovakia and Hungary; on the refinancing of Bivideon BV holding a majority stake in České Radiokomunikace, a.s.; on financing for the acquisition of one of the largest beverages (beer) groups in central and eastern Europe; and private

equity companies on their acquisitions mainly in the Czech Republic. She speaks Czech, German and English.

**BOHDANA PRAŽSKÁ**

*KempHoogstad, s.r.o.*

Bohdana Pražská obtained degrees in civil engineering (1995) and in economics (1996) from the Technical University in Brno. She started her career as a tax adviser in 1997 at Moore Stephens. She joined Linklaters in the Czech Republic in 2001, where she became a managing associate. She joined KempHoogstad as a partner in 2006. She advises large Czech companies, multinational companies and high net-worth individuals on Czech and international tax issues. Ms Pražská has particular experience in the real estate sector, advising developers and investors on the tax aspects of their businesses. Her experience includes advising on the development of the Czech Republic's largest and most successful shopping centres, large-scale residential and mixed-use projects, and the acquisition of property portfolios in the Czech Republic and Slovakia. She is a member of the Chamber of Tax Advisers in the Czech Republic, and of the International Fiscal Association.

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