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Brief overview of limited liability companies under the Business Corporations Act

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The Business Corporations Act (the **"BCA"**) will have a substantial influence on limited liability companies, in particular by its liberalisation of their overall legal regulation and removal of certain problematic provisions of the current Commercial Code. However, the new possibilities could also result in unwanted consequences, which shareholders should analyse in advance.

The BCA will give shareholders more freedom to regulate their mutual relations. Shareholders will have more scope to stipulate the rights attached to their ownership interests and also (unlike joint-stock companies) obligations. For example, a memorandum of association of a company could stipulate that the shareholders (or only some of them) are obliged to work for the company or provide services to it. In the event of a transfer of ownership interest, such obligation would pass to the purchaser.

The BCA will also allow companies to have more than one type of ownership interest, to which different rights and obligations will be attached. For example, the obligation to work for the company can be attached to one ownership interest and an obligation to contribute a higher sum of money to the company can be attached to another one. Unlike in the current state of affairs, it will also be possible for a shareholder to own more than one ownership interest (i.e. the ownership interests of one shareholder will not automatically merge). This will allow, for example, a shareholder who bought a second ownership interest to transfer it later without having to follow a complicated process in order to divide its ownership interest.

Under the BCA, an ownership interest can be represented by a certificated security called a "common certificate". This will be possible only in respect of ownership interests the transfers of which are not restricted or conditional. For the transfer of such security, an oral agreement, endorsement and hand-over will be sufficient. For other ownership interests, a written agreement with verified signatures will still be required.

The BCA will also facilitate the incorporation of new companies, in particular by introducing a substantial decrease in the minimum registered capital requirement. The minimum contribution will be only CZK 1 (currently CZK 200,000 / app. EUR 8,000). However, in the event of such a low contribution, the risk of insolvency (including all related consequences in respect of the executive directors and shareholders) should be considered. The rules stipulating in-kind contributions will also be loosened. An expert to make an evaluation of an in-kind contribution will no longer have to be appointed by a court. The requirement that each in-kind contribution must consist of property that the company can use for its economic activity will also be cancelled. However, it will still not be possible to use work, services or receivables toward the company as contributions.

Another ground-breaking change to the current status is that it will be possible to acquire an ownership interest from a person who did not own such ownership interest, provided that the purchaser acts in good faith.

Under the BCA, a memorandum of association can stipulate that the shareholders have an obligation to provide contributions outside the registered capital of the company. The size of such mandatory contributions will not be limited by the BCA (today, it is limited to one half of the registered capital). The shareholders can, of course, stipulate such limitation in the memorandum of association. To protect shareholders against unreasonable mandatory contributions, the BCA introduces the right of a shareholder who did not agree to the mandatory contribution to exit the company.

Exiting the company will be also possible for other reasons stipulated by the BCA. However, a memorandum of association cannot add any more reasons for exiting . On the other hand, it can prohibit exits for some or all reasons stipulated by the BCA. If an exit is not prohibited, a shareholder could exit from the company if the general meeting decides, against the will of such

shareholder, to materially change the business activities of the company or to extend the duration of the company. Furthermore, if a memorandum of association makes a share transfer conditional on the consent of a specific body, and such body either refuses to give such consent without stating any reasons or fails to decide on such consent within six months, the affected shareholder may also exit.

After a shareholder exits a company or otherwise ceases to be a shareholder without leaving any legal successor (for example, in the event that a shareholder dies and the memorandum of association prohibits the inheritance of ownership interests), the vacant ownership interest will no longer be automatically transferred to the company. The company will dispose of such ownership interest as a proxy for the exiting shareholder and it will have to sell it without unnecessary delay for an adequate price. Such price will then be (after the deduction of costs and the set-off of any receivables toward the former shareholder) paid to the former shareholder as a settlement share. Given the fact that this rule will usually not be advantageous to the former shareholder (as the amount of the settlement share will depend on the price for which the company sells the ownership interest) the BCA allows shareholders to stipulate that the settlement share will be calculated as a proportional part of the equity or real value of the company.

The obligation to establish a reserve fund will also be cancelled. To dissolve a reserve fund in an existing company, the deletion of the relevant provision from the company's memorandum of association will not be sufficient but the executive directors will subsequently also have to decide on such dissolution.

There will also be new rules relating to general meetings. The BCA allows a company to lower the quorum stipulated by the law or to use technical means (such as voting by email) to vote at a general meeting (or to adopt a decision outside the general meeting). On the other hand, the rules for convening a general meeting will be stricter. An invitation to a general meeting will also have to list each decision that it is proposed be taken. However, shareholders will be still allowed to waive their right to convene a general meeting in a timely and due manner. A shareholder will be allowed to challenge the validity of a general meeting only if such shareholder files a protest at the general meeting (or, alternatively, without protest only if such shareholder does not attend the meeting or the reason for such invalidity could not have been discovered during the general meeting).

The changes will also affect executive directors. The BCA will stipulate new rules in the event of a conflict of interests (which will regulate situations such as the execution of an agreement between a company and its executive director or his/her relative) which will protect companies against any abuse by executive directors of their signing authorities. It will also be possible to stipulate in a memorandum of association that the executive directors shall form a collective body, which will make the legal position of executive directors closer to that of the board of directors in a joint-stock company (for example, in the event of an even division of votes, the vote of the chairman will be decisive). If an agreement on performance of the office of an executive director does not stipulate any remuneration, the office will be performed for no remuneration.

The BCA will also remove certain problematic provisions of the Commercial Code, such as the prohibition on the chaining of limited liability companies or the problematic Section 196, which regulates transactions that constitute a conflict of interest and which currently often result in the invalidity of disposals of material assets for non-compliance with formal requirements.

Generally, the BCA will bring a lot of new possibilities to limited liability companies. However, we recommend great caution when using them. For example, if a memorandum of association stipulates an unlimited contribution obligation and, at the same time, prohibits exiting from the company, a minority shareholder could be put in a difficult situation in the event that such shareholder is obliged to pay an unreasonably high contribution. Even if exiting were allowed, such shareholder will be exposed to the risk that the amount of his/her settlement share will depend on the price for which the company will sell its ownership interest. To prevent such risks and similar surprises, all shareholders should pay great attention when modifying memoranda of association to reflect the new legal regime.

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