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Transfers of assets in light of Section 196a(3) of the Czech Commercial Code

Introduction

Within the operations of business companies, various transfers of assets take place between the companies and other persons that are in a close legally defined relationship with them. Because of the possibility to abuse such transfers easily to the detriment of the company and for the purpose of protecting a company's creditors and minority shareholder, these transfers are subject to a stricter regime of control under Section 196a(3) of the Commercial Code. Below we bring you an analysis of the above provision and also information how to apply this provision in practice.

Section 196a(3) regulates the situation where the company acquires assets from the range of persons defined in the law (see below) for a counter-value in the amount of at least one tenth of the subscribed registered capital as of the acquisition date or transfers the assets at such value to these persons for a consideration. If such transfer of assets is to take place, the value of the transferred assets has to be stipulated based on a valuation prepared by an expert appointed by the court in the same manner as in the case of a non-monetary contribution to the registered capital of the company. If the transfer of assets takes place in the first three years of the company's existence, it must be approved by the company's general meeting. The Commercial Code does not stipulate when the consent to the transfer of assets must be granted by the general meeting.

The above provision applies to transfers of assets where the company is one part of the contractual relationship and one of the following persons is the other part:

- member of the statutory body or the board of directors of the company
- proxy holder
- another person authorised to enter the related contractual relationship on behalf of the company (conclude the respective agreement)
- persons close to the above persons
- founder of the company
- shareholder or the person acting with the shareholder in agreement
- person controlled by the company
- person which makes a concern together with the company

The Commercial Code stipulates an exemption from the above obligations (i.e., the above obligations do not apply) for transfers of assets taking place within regular business relationships or at the incentive or under the supervision of the state body or in the stock exchange or similar regulated market.

Sanctions

As decided by the Supreme Court (29 Cdo 2011/2000), breach of the obligation to stipulate the value of the transferred assets based on the valuation prepared by the expert appointed by the court causes the invalidity of the respective legal act by operation of law. If the consent of the company's general meeting is required for the transfer of assets, the absence of such consent in compliance with the judicature of the Supreme Court (29 Odo 1137/2003) does not cause the invalidity of the above legal act, only its ineffectiveness, i.e., it shall become effective by subsequent approval of the above legal act by the company's general meeting.

Interpretation ambiguities

The above provisions of the Commercial Code including its application to specific legal relationships in practice pose several questions, the answers to which the expert public has different opinion on.

Assets to be transferred

When considering whether the transfer of assets is subject to Section 196a(3), it is first necessary to interpret what subject matters of legal relationships are included under the concept of assets pursuant to the Commercial Code. The reply to this question could be found in Section 6(1) of the Commercial Code, under which the assets are defined as things, receivables, other rights, and other money assessable values. Section 196a(3) should thus apply to the transfer of assets (movable or immovable) but also to the assignment of receivables, transfers of rights or the transfers of other money assessable values (e.g., know-how). This conclusion can also be supported by the reasoning of the Second Directive of the Council dated 13 December 1976 (77/91/EEC on coordination of protective measures required for the protection of the shareholders and third persons in the member states from the companies upon establishment of joint stock companies and upon maintenance and change of the registered capital). The purpose of this directive, whose provisions are implemented into Czech law by Section 196a, is the maintenance of the registered capital of the company and the protection of creditors' rights against unauthorised distribution of equity (assets) to the shareholders. From the above, it can be concluded that Section 196a(3) should be applied to all legal actions whose object is performance for a consideration, e.g. also a licence agreement for industrial property and agreements on the provision of services.

Regular Business Relations

The aforementioned Section of 196a(3) does not apply to transfers of assets within regular business relations. In this context, the main question is which transfers of assets fall under the regular business relations, as neither legislation nor judicature defines closely this term. Particular

transfers of assets may be deemed by some companies to be acts that fall under their regular business relations, whereas for other companies the same transfers would not be considered to be under regular business relations. Each company should assess whether a given transfer of assets is "regular", examine whether it or a company with a similar scope of business performs these kinds of transfers regularly (be it according to the scope of business or within its corporate existence), and check the conditions under which the transfer is conducted. If the company acts as it would normally act with respect to a third person unrelated to the company or under conditions which are used for similar acts within regular business relations, it should indicate that the act is conducted within regular business relations.

How to act

Under the threat of invalidity of the legal act by operation of law, we recommend examining carefully all transfers of assets for which all of the provisions of Section 196a(3) of the Commercial Code may be potentially applied and especially assessing whether it is possible to apply potential use of the exemption related to regular business relations for the respective transfer. If the statutory body of a company comes to the conclusion that the exemption can be used for the transfer of assets and, for this reason, the company is not obligated to apply Section 196a(3), it is recommended to record this conclusion in the minutes including the information stating why the statutory body finds the action to be regular.

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