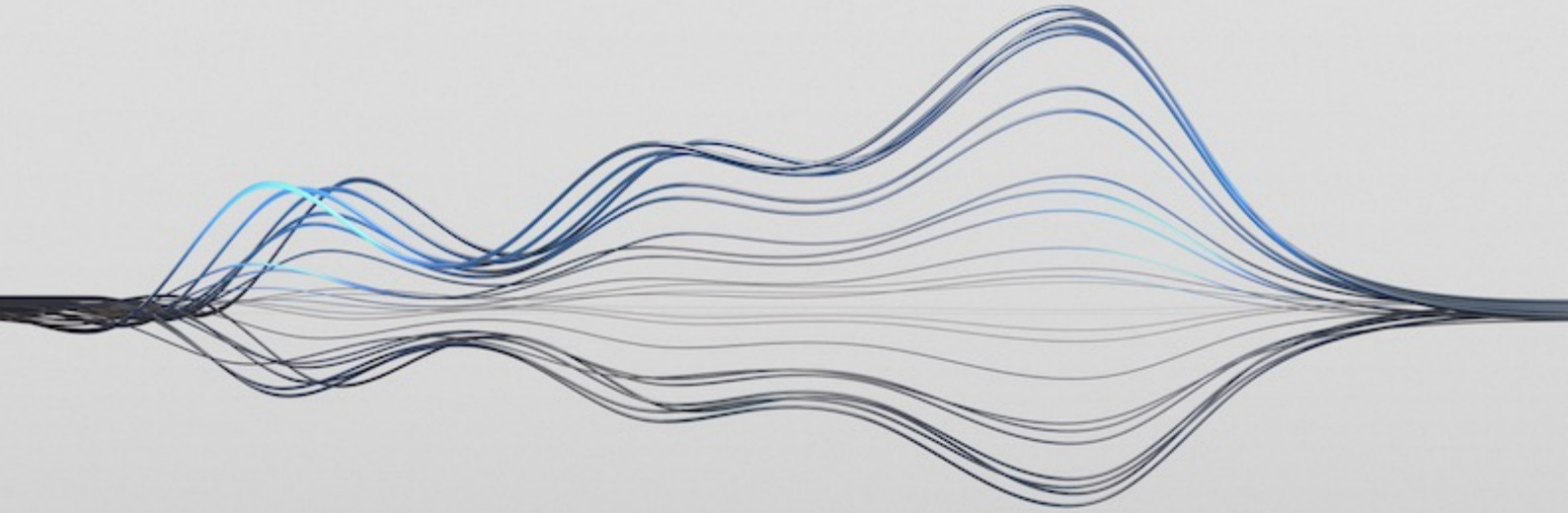
CZECH REPUBLIC

Global Guide to Directors' Duties



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DOWNLOADED: 29 APR 2024

Czech Republic

Last modified 31 January 2024

Corporate entities

What type of company is typically used in group structures?

Similar to most jurisdictions, the Czech form of a private limited company, "*společnost s ručením omezeným*" in Czech (s.r.o.) is the recommended type of corporate entity in group structures.

Types of director

What is a "director"?

There is no specific definition of the term "director" in Czech company law. Basically, the law defines a director by setting out the criteria for how directors can be appointed and what their duties are. It can therefore generally be said that a director describes someone who is a "statutory body" of a company, manages the affairs of a company on behalf of its shareholders as a director and is registered as such in the Commercial Register.

What are the different types of director?

There is only one type of director in an s.r.o. under Czech law.

However, for the sake of completeness, please note, that a fairly similar position to a director may be assumed by a proxy, who may be authorised by an s.r.o. to carry out juridical acts associated with the operation of a business enterprise or its branch, including those which otherwise require a special power of attorney. A proxy's scope of power is however limited compared to a director.

Eligibility

Who can be a director?

A director must either be a natural person with full legal capacity or a legal person. If a legal person is appointed, it must authorise a natural person to represent it in the body (i.e. be the director); otherwise, the legal person is represented by a member of its governing body. Any such authorised person must fulfil all the eligibility requirements applying to a natural person who wishes to become a director.

Furthermore, a director has to be a person not lacking integrity within the meaning of the Czech Trade Licensing Act, must not have anything which is an obstacle to a trade and must not be a person whose property (or the property of a company in which the director has worked or has held the same position in the last three years) has been the subject of insolvency proceedings.

Minimum / maximum number of directors

An s.r.o. must have at least one director and no upper limit is set by Czech law. The company's articles of association may, however, specify a greater minimum number and/or specify a maximum.

Appointment and removal

How are directors appointed?

Directors of an s.r.o. are elected by the General Meeting or by the sole shareholder acting within the scope of the General Meeting. The registration of a director in the Commercial Register is only declaratory, and therefore the director may perform their duties and may represent the company from the date of the General Meeting's decision on their appointment, unless the decision determines the effectiveness of the appointment at a later date. Prior to or upon appointment, the director normally receives from the company a written draft management agreement concluded between the company and director, which regulates their mutual rights and obligations.

How are directors removed?

The termination of the office of the director occurs on the day of the decision of the General Meeting to dismiss that person from office, unless a later date is specified in the decision. If a director does not want to continue in the performance of their office for any reason, they may resign from their position by making a notification to the General Meeting. However, they may not resign in a situation unsuitable for the company and their position shall only end one month after the delivery of such notice, unless the articles of association or the management agreement stipulates otherwise or the General Meeting approves an earlier termination date.

Board / management structure

Typical management structure

An s.r.o. is managed mainly by directors, whose duties are determined by the General Meeting, comprising of all shareholders.

A supervisory board may be established if required by the articles of association, but it is not required by law. This however does not apply to a joint stock company (***akciová společnost*** in Czech), where a supervisory board (or an administrative board, depending on the form of corporate governance) is required.

How are decisions made by directors?

Generally, the law does not specify a decision-making process in an s.r.o. and as such this is therefore determined by the articles of association. However, the law requires that every director must fulfil their duties with managerial care, i.e. with the necessary loyalty as well as with the necessary knowledge and care.

Authority and powers

Every director has a so-called general executive power of attorney and may represent the company and make decisions individually in all matters, even if the company has a multi-member collective board of directors, unless the articles of association specify a different way of acting on behalf of the company (e.g. that two executives must act together). Where a company has multiple directors which do not constitute a collective body, decisions on the management of the company's business require the consent of the majority of them, unless stipulated otherwise in the memorandum of association. The rules for representing the company set out in the articles of association and stated in the Czech Commercial Register must be followed by all directors, as if a breach of such rules occurs, the director will be liable to the company, as directors are contractually bound by such rules.

Delegation

Directors are not entitled to delegate the full scope of their management powers to third parties via a power of attorney and may only delegate a specific task among themselves or to third parties via a power of attorney. A general power of attorney is also prohibited even among the directors.

Duties and obligations of directors

What are the key general duties of directors?

A director is in charge of the company's day-to-day business. The company's business management must be distinguished from the company's representation. While the representation of the company is carried out in relation to third parties, business management is directed inside the company and involves the management of the company, including decisions on business plans. In our view, business management does not include deciding on the long-term strategic plans of the company, as this decision must be taken by the General Meeting.

A director must ensure that the prescribed records and accounts are duly and properly kept and that a register of members is administered and, upon request, must inform the members about any company-related matters.

A director must file any changes to the articles of association to the Commercial Register.

A director must call upon the general meeting to convene at least once a year.

What are directors' other key obligations?

Directors are obliged to file for insolvency without undue delay after learning or having reasonable cause to learn of the company's insolvency. If the executives do not file an insolvency petition in time, they are personally liable to the creditors for the damage or other harm caused by the breach of this obligation.

Directors must take all necessary measures in order to avert imminent insolvency. If they fail to meet this obligation, then in the event of a declaration of bankruptcy of the company, the court may decide, on the proposal of the insolvency administrator or creditor, that the director in question is personally liable for the fulfilment of the company's obligations.

Transactions with the company

Without the consent of all shareholders, a director may not:

- Conduct their own business in the company's sphere of activity or business, including in favour of third parties, or act as an intermediary of the company's business transactions for third parties.
- Be a member of the statutory body of another legal entity engaged in a similar sphere of activity or business, or a person in an equivalent position, unless such entity is within the same group as the company.
- Participate in the business carried out by another business corporation as a member with unlimited liability or as the controlling person of another entity engaged in the same or similar sphere of activity or business.

Liabilities of directors

Breach of general duties

Any director who has violated the duty of due managerial care must return to the business corporation any benefit obtained in connection with such behaviour. Where such return of the benefit is impossible, the obliged person shall pay an equivalent amount to the business corporation in cash.

Every shareholder is entitled to claim, on behalf of the company, compensation or damage against a director or the fulfilment of their obligations, and is entitled to represent the company in the following proceedings. The same rights apply to the subsequent enforcement of the ruling on the matter.

Liabilities on insolvency

See What are directors' other key obligations?

Other key risks

Although the company will be liable for any breach, a director is also personally liable for ensuring the company complies with all of the following requirements:

- Ensuring that there is no violation of contractual obligations. Such violation constitutes an objective liability, i.e. no negligent or intentional conduct is required. All obligations resulting from the Business Corporations Act have to be met.
- Ensuring that the company pays its taxes and advances in time and submits the respective tax declarations.
- Ensuring that the company makes payments in time, especially those regarding the company's employees' social security insurance, health insurance and contribution to the State Employment Policy.
- A director might be found personally liable for crimes defined by the Penal Code, especially economic crimes committed by them during the performance of their duties.
- Ensuring that all administrative law requirements are met fully and in a timely manner, especially those concerning business licences or other titles for executing business and environmental law requirements etc.
- Ensuring that the requirements of the Labour Code and any secondary legislation regarding employees' conditions are met.
- Ensuring that the company meets all the liability requirements specified in the Civil Code as "special liability" cases.

Protection against liability

How can directors be protected from liability?

Liability for damage to the company caused by the director violating managerial care is unlimited. It cannot be limited by the articles of association, management agreement or a contractual arrangement between the company and the director.

In practice, waivers of the company's claims against a member of the statutory body (so-called waiver letter used mainly in the termination of office) are widely used, but given the above inadmissibility of limitation of liability there is a risk of such statements being considered void. These statements may, however, be morally persuasive in preventing the company from enforcing claims against the statutory representative in the future.

Directors' and officers' (D&O) insurance is also common in the Czech Republic. It typically provides both cover for individual directors against claims made against them in in their capacity as director, including defence costs (which applies when indemnification by the company is not available), and company reimbursement when it has indemnified its directors (subject to an excess/retention).

What practical steps can directors take to avoid liability?

Directors should:

- Keep informed about the affairs of the company, particularly its financial position. Directors should have access to up to date financial information, prepare thoroughly for and regularly attend board meetings and familiarise themselves with key legislation affecting the business.
- Make full disclosures to the board and shareholders if they have outside positions or interests which may give rise to a conflict of interest and/or if they have a personal interest in any proposed or existing transaction or arrangement with the company.
- Keep records and take advice – directors should ensure that full written records of board proceedings are made reflecting the reasoning behind key decisions. This should include any alternative courses of action considered. Minutes should also record any disagreement amongst the board and the reasons for that. In addition, directors should ensure that returns and accounts and filed promptly and take professional advice for decisions based on areas outside their personal expertise, for example from legal professionals and accountants.
- Be aware of, and comply with, any group-wide governance policies. These may cover areas such as health and safety, ethics, bribery /anti-corruption, and human rights. Compliance with them is designed to help directors (and employees) fulfil their duties and obligations and minimise the risk of liability.
- Also in a group situation, keep in mind that directors must act in the best interest of their group company. Whilst group interests and that company's interests are usually aligned, this may not always be the case (e.g. when their group company's solvency is adversely

impacted). It is important to keep communication and reporting lines as open and clear as possible between parent and subsidiary companies when issues may arise and seek appropriate advice.

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