

the non-competition prohibition.

The right of the company to benefit from the deal in which the non-competition prohibition was infringed, or transfer of the corresponding rights, will cease to exist, unless it was exercised by the liable person within three months from the date when the company learned of the infringement of such obligation, but no later than upon expiration of one year from the date when the right was established. The statute of limitations in respect of the right to compensation for damage caused by the infringement of the non-competition obligation expires after the expiration of four years following the date when the company learned of the damage and of the person who caused it, but no later than upon expiration of 10 years following the date when the non-competition prohibition was infringed.

(c) ***Obligation of a statutory body or a member thereof to file an insolvency application***

As mentioned above, if the company is insolvent (see Section 3 of the Insolvency Act), the statutory body or a member thereof (if it is entitled to act independently on behalf of the company) is obliged, pursuant to Section 98 subsection 2 of the Insolvency Act, to file an insolvency application in the name of the company. If an insolvency application was lodged in respect of the obligor, but through the fault of the applicant the insolvency proceedings were terminated, or if the insolvency application of the obligor was denied by the insolvency court, these instances cannot be considered as fulfilment of the above-mentioned duty.

In the event that the statutory body or a member thereof fails to fulfil its above-mentioned duty, it shall be liable with regard to the company's creditors for damage or any other detriment caused by the infringement of such duty. 'Damage' or other detriment equals the difference between the amount of receivable identified in the insolvency proceedings and claimed by the creditor for satisfaction and the amount that the creditor in the insolvency proceedings received to satisfy such receivable. Where, however, the receivable arose at the time of company's insolvency and there are no assets of the company (debtor) to at least partially satisfy the receivable of company's creditor within the insolvency proceedings, the amount of the damage corresponds to the whole amount of such receivable.

The obligor shall be released from liability for damage if it proves that the infringement of the obligation to lodge an insolvency application has not affected the amount determined for satisfaction of the receivables claimed by the creditors in the insolvency proceedings. The second situation in which the obligor is released from liability is where the obligor did not fulfil his duty owing to circumstances beyond his control and was unable to influence events.

1.3 **Standards of care**

(a) ***Due care***

Under Section 194(5) of the Commercial Code, directors of joint stock companies are, *inter alia*, obliged to exercise their powers with 'due care'. This term was introduced into the Commercial Code by Act No 370/2000 Coll and from January 1

2001 replaced the previous definition of the standard of care of statutory bodies (ie the term 'proper care'). Through Section 135(2) of the Commercial Guide, the duty to act with due care also applies to statutory bodies (executives) of limited liability companies under the same conditions.

Even if the relationship between the company and its statutory body is governed by a mandate agreement, which requires the statutory body or a member thereof to exercise its office with professional care, the judicature of the Supreme Court stipulates that the term 'due care' represents a special regulation of the standards of care exercised by the statutory body in respect of the company's matters, which has priority over the regulation of the care of the mandator's matters on the part of the mandatory.

Despite the existing disputes in professional literature concerning the definition of 'due care', this term can generally be considered as care exercised by a responsible and prudent business person (statutory body), not only to preserve the company's assets but also to generate maximum profits. The exercise of the position of a statutory body thus includes care of the company's assets in such a way as to prevent damage to the company's assets and focuses on increasing those assets to the maximum possible extent.

Concerning professional qualities, the term 'due care' can be considered as including a certain degree of knowledge and skills on the part of the person performing the position of statutory body. Such skills need not necessarily include the specialised expertise of professionals or experts. The statutory body or its member should rather have skills of a managerial character that enable the person in question, *inter alia*, to recognise that the statutory body does not have sufficient skills to perform a certain matter in the name of the company in the relevant field and subsequently to ensure the assistance of an entity especially qualified in the relevant field. If an opinion is provided by a specialised entity, the statutory body should be capable of assessing the conclusion of such opinion with respect to the company's interests, rather than automatically following the conclusions of the expert opinion without regard to the company's interests.

Where a member of a statutory body has certain expert knowledge, he should use such knowledge when exercising his position. However, obtaining an expert opinion in the field in which the statutory body has expert knowledge does not release the statutory body from its liability for potential damage.

A statutory body may delegate a part of its powers to a third party. In such event, the statutory body will be responsible for the selection of such party in relation to his expertise and ability to exercise the powers entrusted to him and also for the fact that the statutory body duly instructs and monitors such third party.

In addition to the above-mentioned duties in connection with observing due care, it is necessary to take into consideration a number of other factors when assessing the maintenance of the duty of care exercised by the statutory body pursuant to the judicature of Czech courts. One of the most important factors is the degree of risk that the statutory body can or should take in the business management of the company and for the purpose of generating profits. The circumstances of individual events when damage is caused to the company by its statutory body or its

members naturally differ. Despite making the liability for damage objective, it is necessary to approach each case on an individual basis, taking into account all relevant circumstances.

Even though the law does not stipulate with absolute clarity how best to ensure that the standard of due care is observed, preconditions would include:

- knowledge of the obligations of the statutory body;
- knowledge of the company's interests and taking them into consideration;
- decision-making on the basis of all available background documents; and
- procurement of evidence to prove the exercise of due care.

Knowledge of the obligations of the statutory body presumes requesting all necessary relevant information and documents, as well as due and full acquaintance with such obligations.

The knowledge of the company's interests is based on the knowledge of the essence of its business activities and the legal framework regulating those activities. This precondition includes to a certain extent the obligation of loyalty (see below), that is, the duty to put the company's interests before the director's or executive's personal interests or those of third-parties (including the members or shareholders).

Decision-making on the basis of all available information includes in particular the necessity to procure all necessary information, opinions and analyses concerning the adoption of relevant decisions. On the basis of background information and documents, it is necessary to consider all relevant scenarios before taking the final decision, as well as the grounds for the adoption of a resolution with regard to the company's interests. It is also necessary to ensure good conditions for cooperation and to consider the use of expert consultants' services.

Acting with due care can be demonstrated by duly maintained and archived records and all other documentation recording all documents and reasons for the adoption of resolutions. It is also important to keep minutes of the statutory board's meetings.

(b) Loyalty obligation

In addition to due care, legal theory and case law impose an obligation on the statutory body to fulfil the obligation of loyalty in relation to the company and its interests. This obligation of statutory bodies is not directly stipulated in any legal regulation. Nonetheless, it can be deduced from certain provisions of the Commercial Code which regulate the relationship between the company and the statutory body. Legal theory includes discussion of the extent to which the statutory body's obligation to act with due care includes its loyalty obligation regarding the company. In the opinion of the authors, it is difficult to imagine that the statutory body could infringe the loyalty obligation towards the company without at the same infringing the obligation of due care in company matters. The loyalty obligation is demonstrated to the extent that the statutory body must act in the company's interests, and this includes several partial obligations.⁴ First, there is an obligation to

4 See Čech, P. "Due care and loyalty obligation", *Právní rádce* (in English, *Legal Advisor*), 2007, No 3, p 13.

refrain from misusing the company's sources or commercial and other opportunities available to the company for its own benefit, or for the benefit of a third party. Further, there is a duty to fulfil the obligations of the company's statutory body, and to use expert knowledge and skills in favour of the company.

1.4 To whom duties are owed

If liable for damage, statutory bodies or the members thereof shall primarily be liable to the company.

In addition to direct liability to the company, the law imposes the following duties, responsibilities and liability on the statutory bodies and their members:

- shared liability of the members of the statutory bodies (as sureties) for the company's liabilities (Section 194(6) of the Commercial Code);
- direct liability of statutory bodies or the members thereof to third parties as a result of a breach of obligations during transformation⁵ of companies, or under the Insolvency Act;
- no-competition duty with specific consequences (see section 1.2(b) above); and
- administrative penalties imposed on the statutory body or the members thereof.

1.5 Common defences to and exemptions from liability

Strict liability applies under the Commercial Code, that is, the liability is imposed regardless of whether or not the liable party – the statutory body or a member thereof – is at fault. However, such liability is not absolute, as there are certain exemptions. These exemptions apply where an obstacle to fulfilling the duties of an executive or director:

- occurred independently of the will of the executive or director and that person was prevented by it from performing his duties;
- the executive or director could not reasonably have been expected to prevent or overcome such obstacle or the consequences thereof; and
- the obstacle was not foreseeable at the moment the obligation was established.

However, liability is not excluded as a result of an obstacle which occurs at a moment when the executive or director has already been in default of the performance of its legal obligation, or as a result of an obstacle which occurs on the grounds of the economic conditions of the obliged party. Exemption is limited to the duration of the obstacle.

In the sense given by the provisions of Section 194(4) of the Commercial Code, the board of directors of joint stock companies must follow the instructions and principles given and approved by the general meeting, unless these instructions and principles are in conflict with law and the company statutes. If the directors'

⁵ The transformation of companies is governed by Act No 125/2008 Coll, on transformation of companies and cooperatives, as amended. The transformation of companies includes (i) merger, (ii) demerger, (iii) transfer of business assets to a (sole) member and (iv) change of legal form (type) of the company.