

Rights of Minority Shareholders

The protection of minority shareholder's rights in the Czech Republic is recognized as one of the essential aspects of strengthening the role of the local capital market and attracting new investors to it. This Fact Sheet focuses on the rights of shareholders in joint-stock companies and briefly on the rights of partners in limited liability companies as these types of companies are most commonly used for setting up businesses in the Czech Republic.

GENERAL INFORMATION

Comprehensive information about every existing company established under Czech law can be obtained from the Commercial Register, which is publicly accessible at www.justice.cz (official website of the Czech Ministry of Justice). The published information includes basic data such as companies' registered offices and names and addresses of their representatives (statutory bodies), as well as their registered capital and how it was paid. The records and complete history of each company are accessible. Searching for people according to their personal data is also possible. Each company listed in the Commercial Register has to deposit its basic documents: annual reports (or at least financial statement including balance sheets) and reports on relations between related entities (describing relations in the holding-type groups, e.g. companies linked by one controlling entity) where applicable. The quality of these mandatory documents is considered important evidence of the given company's credibility. The mandatory documents are subsequently digitalized and they are available in increasing numbers on-line. Therefore, the Commercial Register is a plentiful initial source of information concerning the history of most subjects in the market in the Czech Republic.

CAPITAL MARKET SUPERVISION

The highest authority in the Czech Republic with regard to the supervision of the capital market and its services is the Czech National Bank (in Czech: Ceska narodni banka or CNB). The services on the capital market (e.g. intermediation of deals with stocks, bonds, allotment certificates, etc.) are provided exclusively by investment firms, which are always legal entities licensed by the CNB. There also exist investment intermediaries, which are permitted upon registration with the CNB to offer some simpler services on the capital market (e.g. intermediation of investors' orders to investment firms).

JOINT-STOCK COMPANY

The most convenient type of company with regard to the interest of capital investors is the joint-stock company. The main advantages of a joint-stock company for investors, i.e. the simple transferability of shares and strictly supervised regular reporting of companies admitted to the regulated public capital market, also represent the most important institutional protection of the rights of minority shareholders.

However, the majority of joint-stock companies in the Czech Republic are formed without an initial public offering and the companies usually do not pursue the admission of their shares to the regulated public capital market; such companies are then less prepared to disclose all of their data to the public and are thus less prepared to prove their credibility to potential investors. Changing these situations represents one of the most widely recognized challenges for all entities involved.

The rights of minority shareholders are protected by a number of provisions of the Commercial Code, such as the provisions regarding the majority required for passing particular resolutions of the general meeting of a company, e.g.:

- *At least a two-thirds majority of the votes of shareholders present on the general meeting is required to modify the statutes of the company, to increase or to reduce the amount of registered capital, to decide whether to offset a debt of the company against the amount of the payable issue price of shares or to approve a contract on the sale or lease of the company's enterprise; where the general meeting decides to increase or reduce the amount of registered capital, such decision shall require approval by no less than a two-thirds majority of the present shareholders of each class of shares (or interim certificates) issued by the company;*

- *At least a three-fourths majority* of the votes of the shareholders present at the general meeting owning the relevant shares is required *to alter the class or type of such shares or the rights attached to a particular class of shares, or to restrict the transferability of registered shares or to withdraw shares from trading on the regulated public capital market;*
- *At least a three-fourths majority* of the votes of the shareholders present at the general meeting is required *for cancellation or restriction of the pre-emptive rights attached to convertible bonds or preference bonds, for cancellation or restriction of pre-emptive rights or subscription of new shares, for approving a control agreement, an agreement on profit transfer, or for their amendment, or for an increase in registered capital through non-monetary contributions;* where a company issued more than one class of shares, approval by at least a three-fourths majority of the votes of the present shareholders owning each class of shares is required.

The majority required for passing a particular decision of the general meeting can be increased by the statutes of the company – this is highly recommended as one of the most important measures protecting the influence of minority shareholders on the company.

Shareholders who hold shares with a nominal value exceeding the particular share of the registered capital of the company (3% of the company with registered capital higher than CZK 100 million or 5% of the Company with registered capital in the amount of CZK 100 million or less) have a right to:

- request that the Board of Directors convene an extraordinary general meeting within 40 days or they may petition the court to authorize them to convene such a general meeting if the board of directors fails to do so. The costs of this procedure are to be settled by the company;
- request that the supervisory board examine the performance of the board of directors in a particular matter;
- request that the supervisory board claim any right to compensation for damages which the company has against a member of the board of directors;
- request that the board of directors include the proposed matters on the agenda of the general meeting;
- request that the board of directors file a complaint with the competent court against shareholders who are in default with payment of the issue price of their shares or to expel them from the company.

Where the board of directors or the supervisory board fail to comply with the above-mentioned requests, the shareholders are entitled to file a complaint with the court in the name of the company concerning damages or amounts outstanding with regard to the issue price of shares.

As a means of protection of a share in a company could also be seen a pre-emptive right of each shareholder to subscribe for a portion of the company's new shares, in proportion to his holding in the existing registered capital provided that such shares are to be subscribed by monetary contributions.

A minority shareholder can be forced to give up shares of the company ("squeeze-out") only under the conditions strictly prescribed by law; the most usual type of such a squeeze-out is *the Right to Buy Out Participating Securities (Section 183i of the Commercial Code)*: A person who owns, in a particular company, participating securities (or substituting securities) whose total nominal value is equal to at least 90% of such company's registered capital or participating securities to which at least 90% of voting rights are attached, has a right to deliver to the board of directors an application requesting the convening of a general meeting for the purpose of adopting a resolution on transference of all the other participating securities in the company to him. The adoption of such a resolution requires at least nine-tenths of the votes of all owners of participating securities whereby the owners of preference shares and the principal shareholder are entitled to vote. The price of the securities has to be substantiated and verified by an expert's opinion. The buy-out is possible only upon previous approval of the CNB, which is obliged to consider whether the price for securities is appropriate; should any doubts arise, the CNB shall act in accordance with the interests of the minority shareholders. There also exists the institution of *Winding-up of a Joint-Stock Company and Transfer of its Business Assets to One Shareholder (Section 220p of the Commercial Code)*, which is applicable under similar conditions and effects into dissolving the Company. The best way how to prevent the above mentioned squeeze-out is to increase the majority of the votes required for passing the decision of the general meeting.

LIMITED LIABILITY COMPANY

Establishment of a limited liability company is the most common option of innovative entrepreneurs wanting to develop their activities. The low costs of establishment and somewhat closer relationship of the company's partners are considered as the main advantages of this form. The business share of each partner can be transferred to the other partner or to a third party; however, this should be expressly allowed by the memorandum of association. The main disadvantage is that a partner cannot withdraw from the company based on his sole decision, i.e. without the agreement of all other partners or without a court decision stating that the partner shall be not forced to remain in the company. The partner can be expelled from the company only if he does not fulfill his obligations (typically if the partner fails to pay his monetary investment).

The partners of a company whose contributions exceed a total of 10% of registered capital are entitled to request that executive officer of the company convene a general meeting and to convene a general meeting by themselves if the executive officer fails to do so.

Other than demanding information relating to the company's performance, the partners also have the right to inspect the company's documents and check the data contained therein, whether personally or through their own auditor or tax adviser.

At the general meeting, each partner has one vote for each CZK 1,000 of his contribution to the registered capital of the company, unless the memorandum of association states otherwise. A two-thirds majority of the votes of all partners is required for decisions regarding, for example, amendment of the statutes and/or memorandum of association, change of the registered capital of the company, acceptance of a non-monetary contribution, and for a decision whether to offset a debt of the company against the amount of the payable contribution of a partner or to approve a contract for the sale or lease of the company's enterprise. The required majority could be increased by the memorandum of association. If a decision of a general meeting amends the memorandum of association, the approval of the Partner who is affected by such a change is also required. An amendment of the memorandum of association affecting all partners requires the approval of all of them.

SUMMARY

Institutional protection of minority shareholder's rights in the Czech Republic is today on the standard European level; existing risks can be reasonably handled through proper legal measures. The massive growth of the Czech economy (6.1% GDP growth in 2005, 5.8–6.6% GDP growth estimated in 2006) and its industrial tradition offers an increasing number of interesting investment opportunities in the near future which are only waiting for investors to explore.

LINKS

www.justice.cz

(Ministry of Justice website with public access to the Commercial Register)

www.cnb.cz

(Czech National Bank website)

http://www.sec.cz/export/EN/Lists/List_of_Licensed_Entities.page

(List of entities licensed to provide services on the capital market)

www.pse.cz

(Prague Stock Exchange website)

www.rmsystem.cz

(RM – System website – organiser of off-exchange trading)