

MANDATORY AND DEFAULT REGULATION IN COMPANY LAW IN CZECH REPUBLIC / Kateřina Eichlerová

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Abstract: *The distinction between mandatory and default rules is very important. If default rules are considered mandatory, this leads to a restriction of freedom. Conversely, if mandatory rules are considered default, this leads to a violation of the law and undesirable interference in the sphere of persons who should be protected by law. The article focuses on the development of the nature of company law in the Czech Republic and shows the current state of discussion and case law in this area. The author concludes that the scope for private autonomy has increased considerably with the recodification of private law. This is caused not only by a more liberal regulation of companies contrary to pre-recodification, but also by the intense discussion that the new regulation has provoked. Thanks to the new legislation, the institutes of company law can be rethought. This then allows the start of a teleological interpretation of rules in searching their natures.*

Key words: *mandatory rule; default rule; company law; joint representation of the managing director and the proctor officer [prokurista], commercial law, Czech law*

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1. INTRODUCTION

The key question of whether the regulation of company law is rather mandatory or default is closely related to the question of the nature of a company. If we consider company a *nexus of contracts* (Davies, 2002, p. 9 et seq.; Havel, 2010, pp. 40–62; Kraakman et al., 2017, p. 5 et seq.; Pelikánová & Pelikán, 2015, pp. 30–32; Pihera & Dědič, 2010, pp. 72–89), we can come to conclusion that the constitutional general principle “what is not prohibited, is allowed” is applicable.¹ If we consider company an *institution*,²

¹ Czech Resolution No. 2/1993 Coll. on Proclamation of the Charter of the Fundamental Rights and Freedoms (hereinafter referred to as the “Charter of the Fundamental Rights and Freedoms”), Article 2, para 3: “[e]veryone do that which is not prohibited by law; and nobody may be compelled to do that which is not imposed upon them by law.” This rule constitutes basis for freedom, including freedom of contracts.

² When using the term “institution”, I refer to a legal entity created by law in the sense of a theory of fiction.

we can arrive at a different conclusion; what is not allowed by the law is prohibited, unless the question has a purely contractual character without relevance to the functioning of the company as a legal entity (e. g. conditions for transfer of shares). It is really important to consider that the search for the nature of a rule is not only related to a process of interpretation but by the first step of our values. What would we prefer: freedom or legal certainty? The balance between these fundamental approaches of lawmakers is the basis for searching and finding the nature of rules whether a certain rule is mandatory,³ semi-mandatory,⁴ default (Bachmann, Eidenmüller, Engert, Fleischer, & Schön, 2013, p. 18)⁵ or enabling.⁶ Frankly, it should be added that lawmakers use more forms of regulation in company law than these. They use standards with instruction to apply or explain different approach or instruction to regulation of some issues in the articles of association. They sometimes offer a draft of the articles of association (Bachmann et al., 2013, pp. 18–27).

Another relevant circumstance is a depth of company law regulation. A brief regulation is rather more mandatory than a very detailed one which also contains reassuring rules (e.g. Eichlerová, 2016, p. 48; cf. Šuk, 2019, p. 526).⁷

³ Mandatory rule is automatically applied. To derogate such rule by private autonomy is not allowed. Consequences to derogation are invalidity, ineffectiveness, nullity, etc.

⁴ Semi-mandatory rule is a rule from which derogation is limited. To illustrate this, we can take a look at the Czech Act No. 90/2012 Coll. on Business Corporations and Cooperatives (Business Corporations Act) (hereinafter referred to as the "Business Corporations Act"), Sec. 171 which requires qualified majority of the general meeting in a limited liability company for some matters. The memorandum of association can increase the qualified majority. Decrease is forbidden.

⁵ The default rule is only applied in case that a private autonomy is not used (opt-out).

⁶ Enabling rule is only applied if a user chooses it (opt-in). For example, a limited liability company can create a supervisory board (Business Corporations Act, Sec. 201). Majority of the limited liability companies are not obliged to create the supervisory board, however, if a company opt to create a body with supervisory power, it creates the supervisory board and its members shall be registered with the Commercial Register. Another example is the creation of shares with no voting rights assigned to them. The joint-stock company is not obliged to create them. However, if the company decided to create them, it must follow the related statutory rules.

⁷ By reassuring rules, I mean such rules which do not constitute a change of law. Their purpose is not to stipulate that some behaviour is allowed or prohibited as opposed to a latter regulation, but only to announce that the lawmaker considers some behaviour as allowed or forbidden. The same conclusion shall be made without an explicit provision by interpretation.

As an example of this serves the discussion on the possibility to create a specific type of share containing the right to appoint and dismiss one or more managing directors or members of the supervisory board in a limited liability company or in a joint-stock company. Some scholars consider it possible because it is not prohibited by the Business Corporations Act. Other scholars consider it not possible without explicit regulation. Before this question could be answered by a court, the lawmaker modified the Business Corporations Act. Now, the Business Corporations Act contains explicit conditions for creation of this type of share (Business Corporations Act as amended by Act No. 33/2020 Coll., Sec. 194a, 438a, 448b a 458). What is the nature of these rules? In my opinion, they are mandatory in determination of restrictive condition (majority of directors shall be appointed and dismissed by general meeting) but not in allowing them to be created. The basis of this right is an abolition of restrictive share types under the Business Corporations Act as opposed to the Czech Act No. 513/1991 Coll. Commercial Code (hereinafter referred to as the "Commercial Code") and the fact that the appointment and dismissal of the managing directors by decision of the general meeting does not have the mandatory nature.

The level of legal culture, development in society, historical circumstances and approach of courts⁸ (Hopt, 2016, p. 16) also influence the discussion on the nature of a certain rule. It depends on the circumstances, what is perceived as fair. In Czechoslovakia in the 20th century, the approach to law sometimes changed. Before the World War II, we can describe judges' activities in decision-making mainly as legalistic and dogmatic, but in exceptional cases the judges were not afraid to deviate from the wording of the law and to look for its rational meaning (Kühn, 2005, p. 22). During the Stalinist era (the 1950s), we were faced with the activist judicial application of law on the one hand and dogmatism on the other (Kühn, 2005, pp. 34 et seq., 196). A possible paradox is that this approach not only led to criminalization of (possible) opponents of the regime in the "social interest" (interest in maintaining the socialism), but at the outset to the elimination of certain inequalities as well⁹ (Kühn, 2005, pp. 35–36).

Subsequently, a formalistic approach to law had been established. Strict adherence to the diction of the law protected the judge from being blamed of a solution inconsistent with the party line. To some extent, it also protected the addressees of legal norms, because the predictability of the law was ensured by the binding application of the law. Z. Kühn concludes the analysis of the period of the 1960s to the 1980s with the idea that, in the context of a simple social life, so typical for the socialist regime, the binding application of law could have been functional to some extent (Kühn, 2005, pp. 109, 113, 116).

The formalistic approach to law persisted in the general judiciary in the 1990s, and it gradually changed due to the value judgments of the Constitutional Court (Kühn, 2005, pp. 117–149). The recodification of private law, which was based on the value and not on the formalistic interpretation of the law, was an important impulse for a change in consideration which rules are mandatory and which are default.¹⁰

Another example is the question of creation of shares with no right to profit assigned to them. The discussion was similar. In the end, the Supreme Court concluded in its judgment, that it is possible (Supreme Court of the Czech Republic, 27 Cdo 3885/2017 (27 March 2019)). Then, the lawmaker clarified this question in the amendment to the Business Corporations Act (Business Corporations Act as amended by Act No. 33/2020 Coll., Sec. 256, para 1).

⁸ The role of the courts in determining which rules are mandatory is quite unique.

⁹ Z. Kühn mentions the elimination of inequalities between married and non-married children by direct application of the constitution against the explicit wording of the Civil Code or judicial decisions promoting gender equality.

¹⁰ The recodification was not only a response to the lack of regulation, but also to numerous formalistic judgments of the courts, which had been criticized. One example is the judgement of the Supreme Court of the Slovak Republic, 33 Odo 1117/2003 (17 March 2005) in which the court concluded that default interest of a different amount than that determined by law cannot be negotiated. This interpretation with regards to the legal license enshrined in the Charter of Fundamental Rights and Freedoms was not justifiable even before the recodification.

Another case sufficiently illustrating the difficulty of assessing the nature of a statutory rule is the issue of granting a power of attorney for representation at a meeting of unit owners' associations in the absence of the explicit regulation in the statute. In the judgment of the Supreme Court of the Czech Republic, 26 Cdo 1657/2018 (16 October 2019), the Supreme Court admitted that under the Czech Act no. 89/2012 Coll. Civil Code (hereinafter referred to as the "Civil Code 2012"), it is possible to grant a power of attorney, but that it was not possible before 2014 if the charter of unit owners' associations explicitly(!) did not allow it. See judgment of the Supreme Court of the Slovak Republic, 29 Cdo 3399/2010 (25 May 2012). It is interesting that

The lawmaker has two basic approaches to distinguish between the mandatory and default rules. One possibility is the general clause as an open concept which is fulfilled by doctrine and case law. The criteria can be nature of rule, good morals, public order, etc. There are two main advantages: stability of legal wording and flexibility. Change of content can be made by a change of interpretation as a reaction to changes in society. There are also two disadvantages: the difficulty of interpretation and the reduced predictability of judicial decision-making. Another approach is an explicit provision stipulating which rules are mandatory and which are default. For example, the repealed Act No. 513/1991 Coll. Commercial Code in the Sec. 263 stipulates the list of mandatory provisions regulating obligations. As an example of an explicit default provision is using the supplement "unless the statutes stipulate otherwise" (see chapter 2). The advantage of this approach is clarity. The disadvantages are lawmaker's errors, rigidity and misinterpretation of other rules. In my opinion, it is advisable to combine both approaches.

2. THE MODERN HISTORY OF LEGAL FRAMEWORK (1992 – 2013)

Companies, regulated by Commercial Code, Part II, did not have its own rules for determination of the nature of rules similar to the regulation of obligations in the Part III¹¹ (see sec. 263 containing an enumeration of mandatory provisions). Criteria for distinguishing of the nature of the provisions in company law are to be found in the Czech Act No. 40/1964 Coll. Civil Code.¹² Section 2, para 3 of the Civil Code 1964 stipulates: "[t]he parties to civil relations may regulate their mutual rights and obligations by agreement derogating from the law, unless the law expressly prohibits it and unless the nature of the legal provisions imply they cannot be derogated from."

The discussion on the nature of rules regulating companies was not too intensive. The majority approach was that rules were mostly mandatory excluding some rules regulating mutual relationships between (former) shareholders (e. g. agreement on share purchase). In my opinion, this approach has three main reasons. Firstly, an inappropriate legislative technique. Many provisions contained the supplement "*unless the statutes stipulate otherwise*". Many provisions without this supplement were considered to be mandatory with the argument *a contrario*. Those supporting the mandatory nature of company law argued, that if the lawmaker wanted the rules to be default he would use this supplement. Such approach is opposite to the current view.¹³

the constitutional framework did not change since 1993. The principle of private autonomy and the principle of what is not prohibited, is allowed (legal license), were the basis for private regulation under constitutional order. This rigid approach to legal interpretation was, in my view, a relic of the socialist era and it shows that the interpretation of law can have long-standing inertia of approach.

¹¹ Commercial Code, Sec. 263 containing the enumeration of mandatory provisions.

¹² Hereinafter referred to as the "Civil Code 1964".

¹³ However, it is honest to admit that the uncertainties can still persist. The process of adoption of amendment to the Business Corporations Act is good example. The Senate returned the draft of amendment to the Business Corporations Act with one change posing an addition of the supplement "*unless the statutes stipulate otherwise*" into the provision sec. 161 para. 3, second sentence, of the Business Corporations Act regulating the maturity of the fixed share of profits in a limited liability company. In my opinion, the provision

Secondly, it was a paternalistic judiciary which supported this interpretation in a reaction to a very excessive approach to law in the 1990s for business.¹⁴ Thirdly, in the background there was a dispute on the task of company law, especially whether the legal regulation shall be the main and actually the only tool of the design of company law or if company law is the result of other influences (soft tool such as e.g. market of directors and their reputation). This dispute escalated during the preparation for the recodification of private law (Pelikán & Pelikánová, 2009; Richter, 2008). The question can be posed in another way: who is cleverer – the lawmaker or practice? Or, who can give better rules? Is it the lawmaker or the practice? Thus, the nature of rules is also about confidence that practice will find a suitable solution in the certain case rather than the opportunity for misuse of law.

3. CONSTITUTIONAL FRAMEWORK

The basis of company law on the constitutional level is constituted by three fundamental freedoms: protection of ownership under the Article 11 of the Charter of the Fundamental Rights and Freedoms, freedom of business under the Article 26 of the Charter of the Fundamental Rights and Freedoms and freedom of association under the Article 20 of the Charter of the Fundamental Rights and Freedoms. The last one is subject to discussion as to whether it is a basis for political associations, or civic associations, or even associations in the form of business corporations. The question is really important because at the constitutional level it defines limits to lawmaker's regulation of companies.

The key question is whether the lawmaker is free by setting up the regulation of companies as legal persons or it is limited by the Article 20 of the Charter of the Fundamental Rights and Freedoms. Under the Article 20 para 1 of the Charter of the Fundamental Rights and Freedoms: "[t]he right to associate freely is guaranteed. Everybody has the right to associate with others in clubs, societies and other associations. Under the Article 20 para 3 of the Charter of the Fundamental Rights and Freedoms: "[t]he exercise of these rights may be limited only in cases specified by law, if measures are involved, which are essential in a democratic society for the security of the state, protection of public security and public order, prevention of crime or for protection of the rights and freedoms of others." This article is placed under section called "Political Rights". This is a reason why some scholars interpret it narrowly using the argument *a rubrica*.

The interpretation given to another part of doctrine is broader. V. Šimíček argues that the freedom of association cannot be limited only to political associations, but this right is evidenced by the associations established for non-political purposes including

is default without the supplement and the supplement is useless. However, senators were concerned about its interpretation because this supplement is found in similar sec. 348 para. 3, second sentence, of the Business Corporations Act regarding the same question in a joint-stock company, so they were afraid of different interpretation of both rules on the basis of the argument *a contrario*.

¹⁴ In the Czech Republic in the 1990s tunnelling (asset confiscation) as an extensive financial fraud appeared and the lack of regulation was one of the causes for their numerous occurrences. For example, financial assistance had not been regulated until 2001, thus many companies thought that it had been possible under any conditions. Often a company controlled by privatization took over the debts from credit agreements concluded by shareholders in order to control the company.

business corporations (2012, p. 476). The same approach can be seen in case law of the Constitutional Court of the Czech Republic.¹⁵

Nobody can create a business corporation as a legal entity without its existence in a legal form set out by written law. It is given by *numerus clausus* types of business corporations.¹⁶ The question is whether the lawmaker can freely decide to abolish one of the types of business corporations or it can make this decision only in cases listed in the Article 20 para 3 of the Charter of the Fundamental Rights and Freedoms. I am a supporter of constitutional protection of business associations as legal entities associating persons to conduct business. This means that once the legislature creates a form of business corporation, it cannot abolish it without a reason anticipated by the Charter of the Fundamental Rights and Freedoms and without meeting the principle of proportionality (Wagnerová, 2012, p. 26). The abolition of, for example, a limited liability company would thus run counter to the concept of the principle of the material rule of law.¹⁷ If we continue to consider the constitutional framework of company law, the open question is whether the lawmaker can make a flexible law more rigid at any time or can do so only if reasons under the Article 20 para 3 of the Charter of the Fundamental Rights and Freedoms are given.¹⁸ However, the constitutional framework would not for example preclude the legal requirement for the dissolution of unipersonal companies, as they do not exercise the right to associate and it is a fiction that they are business corporations.¹⁹

4. CURRENT LEGAL FRAMEWORK

If we compare the regulation of companies under the Business Corporations Act and under the Commercial Code, we must conclude that new regulation is more liberal, flexible and full of possibilities for choice (enabling rules). For example, in a limited liability company, the ban for chaining of companies was lifted, the minimum share capital was reduced to 1 CZK per share, shares can be created as securities. In a joint-stock company, there is choice of dualistic or monistic model of governance, all elected bodies can be unipersonal, the possibility of the creation of specific types of shares is almost unlimited. There is no doubt that the scope for autonomous regulation of companies as a result of the recodification has expanded.

The Business Corporations Act does not have its own general clause on mandatory criterion. The reason is simple. The Business Corporations Act contains only a part of the regulations regarding business corporations. The basis of regulation is found

¹⁵ The Constitutional Court of the Czech Republic considers that the hunting association is an association under the Article 20 of the Charter of the Fundamental Rights and Freedoms (Constitutional Court of the Czech Republic, Pl. ÚS 74/04 (13 December 2006)). From the reasoning it is obvious that the Constitutional Court puts the hunting association as a legal entity on the same level as other legal entities created as associations of persons including business corporations.

¹⁶ Business Corporations Act, Sec. 1 para 1.

¹⁷ It is interesting to state that repealing all types of business corporations except joint-stock companies and cooperatives had occurred by the Czech Act No. 141/1950 Coll. Civil Code at the beginning of the socialist era. At that time, we could not consider the application of the principle of the material rule of law.

¹⁸ The question can be expressed in another way. Is flexible company law the lawmaker's "gift" which cannot be required to be returned without serious reasons?

¹⁹ Under the Civil Code 2012, Sec. 210 para 2 a legal person composed of a sole member is considered to be a corporation. In this case the constitutional protection is given by protection of ownership.

in the Civil Code 2012 in the section regulating legal persons.²⁰ According to the lawmaker, the mandatory provisions in the Civil Code 2012 should be exceptional, since the civil law is essentially default.²¹

The key rule for distinguishing the mandatory and default rules can be found in the Civil Code 2012, Sec. 1 para 2: *"[unless expressly prohibited by a statute, persons can stipulate rights and duties by way of exclusion from a statute; stipulations contrary to good morals, public order or the law concerning the status of persons, including the right to protection of personality rights, are prohibited."* Thus, we can conclude that under this rule in company law there are mandatory rules which contain direct explicit prohibition (using wording *"is forbidden"*),²² which are protecting good morals²³ or public order,²⁴ or rules regarding status issues of a company. The last one is the most difficult for interpretation.²⁵ The Supreme Court of the Czech Republic confirmed that indirect prohibition is also mandatory for reasons. The prohibition is not expressed in the words *"it is forbidden"*, but the unlawful derogated arrangement is legally invalid, apparent, etc. The key example of an indirect prohibition is hidden in the sense and purpose of a statute under Sec. 580 para 1 of the Civil Code 2012.²⁶ Under Sec. 580 para 1 of the Civil Code 2012: *"[a] juridical act is also invalid if it is contrary to good morals or contrary to a statute, if so required by the sense and purpose of a statute."* According to the explanatory report to the Civil Code 2012, this provision was formulated in response to an entirely formal interpretation of Sec. 39 of the Civil Code 1964, according to which any infringement of the law caused absolute invalidity.²⁷ In Sec. 580 para 1 of the Civil Code 2012 the lawmaker intended to establish (absolute or relative) invalidity only in cases of a qualified breach of law. Thus, the Supreme Court interpreted this legal provision as follows: requiring the sense and purpose of the statute that a legal act contradicts it is invalid, such a statutory provision is mandatory.²⁸

5. CURRENT DOCTRINE

The discussion on the nature of civil law rules, especially company law rules, is very intense after the recodification (e.g. Eichlerová, 2016, p. 42; Eliáš, 2015; Havel, 2013, 2014,

²⁰ Civil Code 2012, Sec. 118–418.

²¹ Czech explanatory report to the Act No. 89/2012 Coll. Civil Code, House Press No. 362, Chamber of Deputies of the Parliament of the Czech Republic, 6th parliamentary term 2010–2013, pp. 582–583.

²² For example, under sec. 116 of the Business Corporations Act the transfer of a member's business shares in an unlimited partnership is forbidden. Beyond the essay, there is the question if this rule is reasonable and constitutionally conforming.

²³ In my opinion, protection of creditors of a company or protection of minority shareholders fall within this category.

²⁴ For example, under the Civil Code 2012, Sec. 145 it is forbidden to form a legal person the purpose of which is to violate the law or achieve a goal in an unlawful manner. .

²⁵ See further.

²⁶ Supreme Court of the Czech Republic, 29 Cdo 5719/2016 (19 September 2017). Supreme Court of the Czech Republic, 29 Cdo 387/2016 (31 October 2017).

²⁷ Czech explanatory report to the Act No. 89/2012 Coll. Civil Code, House Press no. 362, Chamber of Deputies of the Parliament of the Czech Republic, 6th parliamentary term 2010–2013, p. 690.

²⁸ Supreme Court of the Czech Republic, 29 Cdo 5719/2016 (19 September 2017). Supreme Court of the Czech Republic, 29 Cdo 387/2016 (31 October 2017).

2019; Hurychová, 2016; Lavický, 2014; Melzer, 2013; Melzer & Tégl, 2013; Pelikán, 2012; Pelikán & Pelikánová, 2014; Ronovská & Havel, 2016; Šuk, 2019). However, it cannot be said that there is a complete consensus as for which issues in company law are mandatory and which are default.

The most difficult issue is the determination of status rules. In my opinion, there is consensus on the following matters: legal personality, types of legal persons and forms of business corporations, establishment and termination of legal persons, including transformations, business name, seat and the scope of business, determination of the governing body and determination of the basic manner of acting on behalf of a company (Eliáš, 2015, p. 79; Šuk, 2019, pp. 517–518). There is no consensus on the conclusion that all the rules governing the internal organization of capital companies are mandatory with argumentation that they are generally status rules. An extensive discussion is being held, for example on the competence of the general meeting. Can the competence of the general meeting defined by law only be extended by the articles of association or can it be narrowed? We can find the opinion refused by the narrowing of legal competence.²⁹ Some scholars admit delegation of some competence of the general meeting to another body in specific cases (e. g. appointment and removal of a managing director by a supervisory board in a limited liability company (Eichlerová, 2016, p. 47; Pokorná, 2016; Šuk, 2019, p. 525),³⁰ or approval of remuneration by a supervisory board to members of a board of directors elected by a general meeting in a joint-stock company (Hurychová, 2016).

I consider the rules on the status of persons only those which define the essential characteristics of a legal person in general or a specific form of business corporations so that it can be functional, distinguishable from other forms of legal persons and it does not violate legal certainty about its nature. Frankly, other scholars consider status rules more broadly. However, the distinguishing mandatory and default rules is not only about whether the rule is a status rule or not.

I agree with K. Ronovská and B. Havel that the regulation of a company is based on private autonomy and broad default (2016, pp. 38–39). The mandatory rule is an exception which must be based on relevant reasons (Hopt, 2016, p. 5).³¹ K. Ronovská and B. Havel consider test of *mandatory matrix*. Under the mandatory rules fall the rules ensuring good morals (fairness), public order, maintaining the essential legal nature of a legal person in general and essential specifics for specific forms of legal persons, including business corporations, protection of creditors, incl. employees, protection of the legitimate rights of third parties, incl. minority shareholders (2016, pp. 38–39).

²⁹ In the opinion of the Civil and Commercial Division of the Supreme Court of the Czech Republic, Cpjn 204/2015 (13 January 2016) on certain issues concerning the registration of business corporations in the Commercial Register the Supreme Court stated without explanation, that status issues, which are mandatory, include, “for example, the definition of bodies of business corporations and their competence, decision-making of bodies (ie, in particular, convocation, quorum, voting majorities, certification of decisions by majority)” (para I of the opinion).

³⁰ Šuk’s opinion deals with the interpretation of the Civil Code 2012, Sec. 1 para 2; he argues that all arrangements derogating from the status regulation are not prohibited. Only those derogations that violate status regulation are prohibited. This approach allows it to maintain a broad perception of status, including the competence of the bodies, if it is reasonable.

³¹ The reason for the mandatory regulation can be insolvency, securities regulation and regulated industries (e. g. the energy industry).

Each rule in company law shall be interpreted by an aid question. Does this rule regulate essential company characteristics? If the answer is positive, the rule is mandatory. If the answer is negative, we must ask further questions. What is the purpose or meaning of the law? Protection of creditors? Protection of minority shareholders? Protection of employees? Is a specific protected interest a rational reason for limiting private autonomy? If the answer is positive, the interpretation rule is mandatory. This choice of questions is not complete. It should show that the conclusion on the nature of a rule is a result of complex interpretation.

The issue of mandatory and default rules are not so serious if we consider that Czech legal order, like other legal systems in the EU, offers different standard forms of legal entities with different organization and position of members to choose the most suitable one for an individual case (Kraakman et al., 2017, p. 19). We should not forget the possibility of choosing legal forms from foreign jurisdiction, either (Hopt, 2016, p. 15).

6. CURRENT CASE LAW

In case-law regarding mandatory / default nature of the company law recodification, we have two relevant court decisions.

The first decision is the judgment of the Supreme Court of the Czech Republic, 29 Cdo 5719/2016 (19 September 2017) published in the Collection of Judgments and Judicial Opinions under no. R 152/2018. The core of the dispute was the nature of Sec. 207 para 1 of the Business Corporations Act³² and whether it is possible to completely exclude the transferability of shares in a limited liability company by the memorandum of association. The Supreme Court did not find any reasons for the mandatory nature of the provision interpreted, so it considered the rule default. I can add that forming a fully closed-end limited liability company is not contrary to the nature of a limited liability company because it stands on the line between personal and capital companies and it depends on the private autonomy of members whether the limited liability company will be rather personal or capital. The protection of members is sufficiently ensured by the legal requirement to a member's approval to changes in a memorandum of association which influences his or her position. The form of closed-end company cannot be imposed on a member against his or her will.

The second decision is the judgment of the Supreme Court of the Czech Republic, 29 Cdo 387/2016 (31 October 2017) published in the Collection of Judgments and Judicial Opinions under No. R 10/2019. The core of the dispute was whether it is possible to define the manner of representation in a limited liability company in the memorandum of association as joint representation of the managing director and the proctor officer. This question is neither explicitly provided in the Civil Code 2012 nor in the Business Corporations Act. Both Acts contain neither the explicit prohibition nor the explicit permission. Before the judgment was given, this question was intensively discussed (Eichlerová, 2015; Josková, 2013; Pokorná, 2020, p. 1089) (cf. Čech & Šuk, 2016, pp. 31–

³² Business Corporations Act, Sec. 207 para 1: „[e]very member may transfer his or her business share to another member“.

35; Hurychová, 2014, p. 35),³³ Havel concluded that joint representation of the managing director and the proctor officer shall be admissible under the Commercial Code (2010, p. 101).

The court assessed whether the manner of representation to register in the Commercial Register is allowed as follows: *“At least two managing directors act together on behalf of the company, or one managing director together with one proctor officer. If the company has only one managing director, the joint action of the managing director and the proctor officer is excluded.”* The Supreme Court concluded that the part of this provision of the memorandum of association regarding the proctor officer is absolutely invalid, since it is contrary to the status rule on representation of a company by a governing body. Under Czech law, the statutory regulation presupposes the independent representation of each member of the governing body, unless the articles of association stipulate otherwise.³⁴ The Supreme Court concluded that “otherwise” admits only modification with participation of the member of the governing body.

The Supreme Court based its decision on many arguments, of which I have chosen three key ones to comment on. The decision is analysed in detail by P. Čech, who fully agrees with the court’s conclusions (2019). The main argument was that the representation of a legal entity externally is one of the essential competences of the governing body which cannot be removed from the governing body. In general, I agree with this conclusion. However, I do not agree with application of this conclusion in this case. In this case the joint representation of the managing director and the proctor officer is not a removal of representation competence of the managing directors. It was the only alternative to joint representation of two managing directors.³⁵

The second argument was that the scope of representation of the managing director and the proctor officer is not the same. I agree that the scopes are not the same. The managing director is entitled to represent a company in all matters. The proctor officer is entitled to represent the entrepreneur in all matters regarding the operation of business. Although the scope of representation of the proctor officer is narrower than the scope of representation of the managing director, it cannot be a reason for refusal of their combination. I agree that without explicit statutory regulation it is disputable that in joint representation the proctor officer’s scope of representation extends to the scope of representation of the managing director. However, the result of it shall be the conclusion that the scope of joint representation is within the limits of the scope of the proctor officer.

³³ There has not been consensus on this question yet. Some scholars support the admissibility of joint representation of the managing director and the proctor officer, while some oppose it.

³⁴ Civil Code 2012, Sec. 164: *“(1) A member of a governing body may represent the legal person in all matters. (2) Where the competence of the governing body is entrusted to several persons, they form a collective governing body. If the forming juridical act does not determine the way in which its members represent the legal person, each member shall do so individually. If the forming juridical act requires the members of a governing body to act jointly, a member may individually represent the legal person as an agent only if he has been authorized to make a specific juridical act.”*

³⁵ The inadmissible removal of representation competence of a governing body was for example this manner of representation: *“In all cases the managing director acts on behalf of the company together with the proctor officer.”* This provision makes it impossible to act for the members of the governing body without the participation of persons who are non-members. It is contra essential competence of the governing body and therefore it is absolutely invalid.

The last important argument was that if it could be inferred that joint representation of the managing director and person out of a governing body is admissible then this person can be anyone. It would be against the certainty of legal relations and that is a reason for the refusal of this possibility. This argument is serious. However, in my opinion, a suitable solution can be the admission of joint representation of a managing director and a representative who is obligatorily registered with the Commercial Register and with whom the principle of material publicity is connected. There are two typical representatives – the proctor officer and the head of branch (branch manager).

In summary, the Supreme Court dealt with the matter in great detail, but as a result interfered more with the private autonomy of a limited liability company than it was necessary. In my opinion, to be allowed as an alternative is justifiable, but not exclusive, joint representation of a managing director and another representative of a company regularly registered with the Commercial Register. These assumptions were also met in the provision of representation in the memorandum of association. In my opinion, this provision should not have been declared absolutely invalid, on the contrary, this manner of representation should have been registered with the Commercial Register.³⁶

7. CONCLUSION

The distinction between mandatory and default rules is very important. If default rules are considered mandatory, this leads to a restriction of freedom. Conversely, if mandatory rules are considered default, this leads to a violation of the law and undesirable interference in the sphere of persons who should be protected by the law. In my opinion, the scope of the private autonomy has increased considerably with the recodification of the private law. This is caused not only by a more liberal regulation of companies contrary to pre-recodification state, but also by the intense discussion the new regulation has provoked. Thanks to the new legislation, the institutes of company law can be rethought. This then gives rise to the teleological interpretation of rules in the search for their natures.

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³⁶ It cannot be assumed that the Supreme Court of the Czech Republic will change its mind. The reason is that this was the second time that it has dealt with it. Firstly, the Supreme Court accepted this conclusion in connection to the publication of judgment of the High Court in Prague, 14 Cmo 184/2014 (4 August 2015) in the Collection of Judgments and Judicial Opinions under no. R 42/2016. The only option would be an intervention of the lawmaker and addition of the explicit provision of joint representation in the Civil Code 2012. However, this is not too likely.

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