Effect of European Directives on Legal Regulation of the Limited Liability Company in the Czech Law

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1. Introduction

A limited liability company has the basic features of capital companies. But compared to the joint stock company, which is a typically capital company, it shows certain features evoking a personal company (for example a change of the memorandum of association may be still realized by an agreement of all members, members may be bound by the memorandum of association to execute the objective, for which the company was established, by means of their personal activities). Hence the limited liability company is on the border between capital and personal companies and it represents an interim form, which combines the advantages typical for both groups of companies – members of the limited liability company do not assume unlimited liability for the company obligations but they are not alienated from the company to such extent that they would not be known to the company and the company management would be assumed by third persons.

The legal regulation of this form of company allows a relatively speedy and cheap establishing of this company, it provides considerable freedom for a special regulation of internal relations of the company in its memorandum of association and it allows administering of internal matters of the company with lower costs than in case of the joint stock company.

This nature of the limited liability company makes this company very attractive for various types of business but its advantages are also abused in practice. Limited liability companies are sometimes established for property operations damaging persons, with whom the company enters into legal relationships. Hence a question arises whether to tighten up the legal regulation at the expense of restricting some of the advantages of this form of the company or whether to rather strengthen the information position of the members and third persons upon decision-making. When solving this issue, an important role may be played also by European Directives, which inter alia perform also the protective function, the objective of which is to create environment of legal certainty in Member States for investors as well as business partners of companies.

2. Limited Liability Company and European Directives Harmonizing the Legal Regulation in Member States

Express requirements of harmonizing the regulation of a limited liability company in Member states are imposed only by the Twelfth Council Directive on single-member private limited liability companies (89/667/EEC). For the purposes of establishing such company, the member states are obliged to admit and in the same time adopt by means of its legislation minimum protective elements, which the Directive includes.

The legal regulation of the limited liability company is further affected by Directives that in general create the environment of legal certainty for entrepreneurs. These are the First Council Directive No. 68/151/EEC followed by the Eleventh Council Directive No. 89/666/EEC concerning disclosure requirements in respect of branches opened in a Member State by certain types of companies governed by the law of another state. The First Directive regulates the obligation to
disclose basic information about trading companies and tools of such disclosure, manner of acting on behalf of the company and invalidity of the trading company. The Eleventh Directive prescribes what instruments and data have to be published in relation to branches opened in a Member State by companies governed by the law of another Member State.


Other Directives address their requirements to harmonization of the legal position of joint stock companies. Their reflection in the legal regulation of limited liability companies results in approximation of both forms of the companies and in this sense also in unification of legal regulation. This is however not always a benefit in terms of practical usability of the limited liability company as in this way, its main advantages may be suppressed – the simple and directory legal regulation.

Joint stock companies are addressed by a group of Directives regulating procedure of dissolving the company without liquidation and passage of its property and members to a legal successor of the company: the Third Council Directive regulates the procedure of fusion by merger and consolidation with emphasis on protection of shareholders and third persons, the Sixth Directive regulates requirements imposed on harmonization of opposite procedures – divisions of trading companies and the objective of the Tenth Directive adopted at the instance of judgments of the European Court of Justice is to simplify performance of cross-border mergers of various types of capital companies, which are governed by legal systems of various Member States. The Directive is not limited only to a joint stock company but it concerns all forms of capital companies in Member States.

Requirements concerning protection of members and third persons follow from the Second Directive, whose subject-matter is focused only on joint stock companies and starts from the theory of registered capital. These days, this Directive is subject to reforming interventions and its wording is being successively amended.

Therefore the effect of harmonization Directives on the legal regulation of the limited liability company in individual member states may vary – it might be minimum if only those requirements are respected, which are addressed directly to the concerned form of companies or generally safeguard legal certainty of the relations with trading companies of any forms. However, if within legislation of Member States, the limited liability companies were subject to certain requirements laid down by Directives only for joint stock companies, the rules of their establishment and internal relations may be considerably different.

3. Effect of European Directives on the Legal Regulation of the Czech Limited Liability Company

3.1 Single-Member Company

As of amendment of the Economic Code by Act No. 103/1990 Coll., the Czech legal regulation admitted existence of a single-member limited liability company (Section 106n par. 1 of the Economic Code). Nevertheless, the legal regulation lacked any closer details on functioning of such company. It originated from the period almost identical to the period of issuing the Twelfth Directive that was adopted on 21 December 1989 and laid down a deadline for adoption of its principles by 1 January 1992. This date is in the same the date, on which Act No. 513/1991 Coll., the Commercial Code became effective in the Czech Republic. Although the Czech Republic was not a Member State of the European Community then, the content of the Directive was out of doubt taken into consideration when preparing the wording of the Code. The modern history of the limited liability company in the Czech Republic admitted also the single-member form of this company from the very beginning.

The Twelfth Directive on single-member limited liability companies does not address problems of the legal regulation of a single-member company comprehensively. Its basic objective expressed also in its preamble was to coordinate safeguards in relation to members and third persons. This focus of the Directive is expressed in the following principles:

1. The company may have a single member either upon its establishment or as a result of concentrating all business shares in one pair of hands. The Member States may adopt special regulation as regards natural persons as single members of several companies and participation of single-member companies in other single-member companies;
2. Concentration of all shares in the hands of a single member in the course of the company existence has to be published in the relevant register;
3. The single member performs the competency of a general meeting and his decision has to be executed in writing; contracts concluded between the company and the single member have to be executed in writing too.
The Directive does not address other possible issues of a single-member limited liability company and it leaves their solution fully up to national legal systems.

**Single-Member Company**

The first principle is transposed in the Czech legal regulation in the provision of Section 105 of the Commercial Code. The Code allows existence of single-member limited liability companies and for the purposes of preventing establishment of chains of single-member companies founded actually on the basis of one investment, it imposes a ban on the limited liability company to be further a sole founder of a company of the same type. A single-member limited liability company may not be a sole member of another company of the same legal form either. If this happens in the course of the company existence, it is a reason either for dissolution and liquidation of the company or for any provision bringing another member into the company (for example division and assignment of a part of the business share of the single member, decision to increase the registered capital by a new investment of another person). The Code does not expressly determine any sanction in the event that as regards such inadmissible single-member company, the single member did not adopt any measure to correct the illegal state of his company. It would be probably necessary to apply the general regulation of Section 68 par. 6 of the Commercial Code and it would be the court that would decide in the company dissolution on the basis of the reason specified under subsection c) – prerequisites required by law for company establishment ceased to exist.

The statutory restriction applies also the natural persons as members – they may be the sole member of a limited liability company but only in three companies.

The said prohibitions apply also to foreign entities that would like to establish a limited liability company according to the Czech law with a registered office on the territory of the Czech Republic. The effect of the prohibitions on foreign single-member limited liability companies is questionable, however, if their personal status is governed by a legal system other than the Czech one and this legal system did not make use of the permission ensuing from the Directive. If such foreign single-member limited liability company wanted to establish also a single-member limited liability company according to the Czech law, the prohibition would apply. The other way round (a Czech single-member limited liability company is establishing a foreign single-member of the limited liability company according to the law of the state, which did not make use of the possibility of restriction), the provision of Section 105 par. 2 of the Czech Commercial Code shall not apply.

If the Directive states, as one of its objectives, to allow limited liability of an entrepreneur for his obligations, the Czech legal regulation (Section 106 of the Commercial Code) does not distinguish between the multiple-member and single-member companies. The statutory liability obligation is imposed on members of the limited liability company only in a limited extent: the liability is limited in terms of its amount – the sum of amounts of the unfulfilled investment obligation of all members as incorporated in the Companies Register. In the same time, the liability is limited in term of time – the statutory liability of the member for obligations of the limited liability company shall last only until all members fully meet their investment obligation and this fact is incorporated in the Companies Register. Their statutory liability for the company obligations shall cease to exist as of this fulfilment and incorporation of this fulfilment in the Companies Register in final and conclusive manner. The incorporation of payment of the whole investment has constitutive effects in this case. The paid up but unincorporated investments do not cause termination of the liability obligation. If the registered capital was increased in the course of the company’s existence and member or new members respectively assumed the investment obligation, the rules of statutory liability of members would be applied again even though prior to the decision to increase the registered capital, all investments had been paid up and their payment incorporated with the Companies Register. Although the Code lacks an express rule for the so-called old obligations, the statutory liability applies also to the member who becomes a member only during the existence of the company, for example by means of the business share transfer or inheritance.

**Information Obligation**

The public approach to information included in the Companies Register protects in particular third persons who are able to get basic information about the internal structure of the company and adjust their own business decisions to these facts. The fact is that a single-member company raises an increased risk for the creditor as it lacks standard control mechanisms ensuing from the competency of the general meeting. When all decision-making processes are concentrated in the hands of a sole member, who is in the same time a corporate agent, there is a risk of speculative disposals of property when the company may become only a fictitious entity deprived of its assets. Hence third persons should receive at least information about the fact that the company is a single-member one or that all decision-making competencies are executed by a single member respectively.

The second principles ensuing from the Directive is not implemented in the Czech legal regulation of the limited liability company by an assent legal rule. It is achieved by the common operation of the provision of
Section 119 of the Commercial Code, which allows concentrating of all business shares in the hands of one member during the company existence, and the provision regulating entries into the Companies Register. According to Section 36 subsection c) of the Commercial Code, as regards the limited liability company, one shall register the name and residence or the business name and registered office of the company members, the amount of the member’s investment and the volume of its business share. In connection with the provision of Section 32 par. 3 of the Commercial Code imposing an obligation to file a motion to incorporate registered data without undue delay after emerging of the decisive legal fact, this provision represents a sufficient set of rules, by whose means it is possible to realize the requirement laid down by the Directive.

**Competency of the Single Member**

Also as regards a single-member company, it is necessary to distinguish between the body that creates internal will of the company (the sole member) and the body that demonstrates the will on the outside (the statutory body) and has the executive powers in common operation of the company’s undertaking. As concerns a single-member company, such cases are not exceptional when both bodies are represented by the same person. It may also happen that the same person will act on behalf of the company and in the same time it will be a contractual partner of the company. The Twelfth Directive admits all the said modifications of the internal organization of a single-member company. Nevertheless, it requires the written form for decisions of the single member as well as for his acts towards the company.²

In the Czech legal regulation, the implementation of the said rules is concentrated in the provision of Section 132 of the Commercial Code. If the company has only a single member, it is excluded by the very nature of this situation to make decision with the aid of the general meeting. Its decision-making competency is vested in the single member. If the single member is to decide within the competency of the general meeting, formal rules concerning convening and decision-making of the general meeting shall not apply. No chairman or recorder is elected in this case and therefore the Code prescribes, on the basis of requirements laid down in the Twelfth Directive, formal essentials similar to minutes from the general meeting – written form and signature. The form of notarial record is prescribed only for decisions on matters specified in the provision of Section 127 par. 4 of the Commercial Code and further in all cases where a notarial record is taken of a general meeting resolution (for example Section 141 Clause 1 of the Commercial Code). As no general meeting is held, it will be probably necessary to accept the conclusion that in this case, this is a notarial record of an act of the single member.

In terms of the subject matter, the provision on the prohibition of execution of voting rights is excluded therefore the single member is authorized to render decisions even when the investments has not been fully paid up.

The invalidity of the single member’s decisions in the area of the general meeting competency is examined according to the rules on invalidity of general meeting resolutions. Decisions not executed in writing will be invalid. The invalidity has to be proclaimed by court on the motion of persons specified in Section 131 par. 1 of the Commercial Code.

The corporate agent of the company, should he differ from the single member, is bound by the member’s decision as concerns the agent’s conduct therefore he should be notified of the decisions of the single member. The same requirement applies to the Supervisory Board accordingly. Provision of the information relationship between the single member and corporate agents of the company as well as the Supervisory Board is safeguarded by the obligation to deliver decisions of the single member executed in writing to them. In the same time the Code does not anticipate any right of corporate agents and members of the Supervisory Board to participate in decision-making of the single member but on the contrary, it regulates their participation as an obligation should the single member require it.

If the single member is simultaneously a corporate agent of the company, it will be probably impossible to prevent cases when contracts will be concluded between this member as a legal or natural person and the company as legal person different from the member. Conclusion of such contracts is allowed by the provision of Section 132 in its paragraph three and it requires their written form with an officially verified signature or form of notarial report on the single member’s act. Foreign members can make use of verification at diplomatic offices of the Czech Republic or also verification by the relevant body of the concerned case on the basis of a treaty on legal aid respectively.

The Twelfth Directive allows in its Article 5 par. 2 for the Member States to waive the requirement of written form or specifying contracts in the minutes as long as current transactions are concerned concluded under usual conditions. Nevertheless, the Czech regulation did not make use of this possibility of making common commercial relations easier.

### 3.2 Directives creating environment of legal certainty for entrepreneurs and other persons

The requirements of the First and the Eleventh Directives apply to the limited liability company on the basis of the regulation included in Part One, Chapter
Three of the Commercial Code, which includes provisions about the Companies Register (regulation of the obligation to publish information on trading companies). The same Part, Chapter One, Division Four includes rules of acting on behalf of trading companies. General rules, which concern acting on behalf of the company in the period between its establishment and incorporation, and also the rules concerning invalidity of the company, form part of the statutory text specified under Part Two, Chapter One, Division One of the Commercial Code, which includes provisions about trading companies.

The so-called accounting Directives represent the basic standards for the system of accounting regulations, which starts from Act No. 563/1991 Coll., on Accounting. The audit of accounts and requirements imposed on auditors are specified in Act No. 254/2000 Coll., on Auditors.

The said system of rules shall apply also to the single-member limited liability company. Hence its legal regime does not include any variances that would have to be emphasized. Analysis of this part of the legal regulation would exceed the scope of our paper hence we refer to other sources, which address the concerned issues.9

3.3 Directives Intended for Regulation of Joint Stock Companies

As concerns this portion of the Conventions, the condition and development of the legal regulation in the Czech law was predetermined by the system of the Commercial Code. Exclusion of general issues common for all companies and their inclusion into Part Two, Chapter One, Division One of the Commercial Code did allow considerable shortening of the overall extent of the regulation but in the same time resulted in the fact that certain requirements of the European Directives intended only for joint stock companies were embodied into this systematic part of the Commercial Code and hence their effect was extended to all forms of trading companies.

As regards the limited liability company, this applies in particular to the regulation of creating and protecting the registered capital, which reflects the requirements of the Second Directive. The provision of Section 59 par. 2 of the Commercial Code expresses principles ensuring for the numerical value of the registered capital incorporated in the Companies Register to be actually covered by assets of the company. In this respect, problems were caused in particular by non-monetary investments, in relation to which company sources could have been fictitiously overestimated. Therefore it is determined in Section 59 par. 2 of the Commercial Code that the subject-matter of investment has to be connected with the intended line of business or activities of the company and its economic value must be ascertainable and eligible of being expressed in numbers. Investments resting in the members’ activities for the company are forbidden as it is difficult to evaluate them objectively except for the fact that the very execution of activities or services does not meet the requirement for the subject-matter of the investment to be property. The Commercial Code at this point reacts to the requirements laid down in Article 7 of the Second Directive.

Another system of rules starts from Article 10 of the Second Directive and it determines the requirement of evaluating non-monetary investments by a report of an independent expert appointed by court. Also in this case, the aim of the regulation is to ensure objective evaluation of the non-monetary investment and to prevent its overvaluation. The amendment of the Second Directive by the Directive No. 2006/68/EC of the European Parliament and of the Council in its newly inserted Article 10a determines when the Member States do not have to evaluate the non-monetary investments by an expert. These rules will be supplemented to the Commercial Code by its amendment that is to be passed by the end of this year. The said amendment should further admit also the so-called financial assistance, which was forbidden by now by Article 23 of the Second Directive. It should be possible to provide an advance, loan, credit or other monetary performance or to provide security for the purposes of acquiring shares in the company both in the joint stock company and in the limited liability company.

Special rules for investments and creation of registered capital are laid down in the subsequent regulation of the limited liability company, which also includes special rules for a single-member company. In the provision of Section 111 par. 2, the Commercial Code requires complete fulfilment of the investment obligation assumed by the company founder and expressed by him in the founder’s deed prior to incorporation of the company with the Companies Register. The regulation makes use of the provisions of the preamble of the Twelfth Directive, according to which the Member States may freely determine the rules preventing possible dangers ensuing from the fact that the company has only a single member, and focus these rules in particular to secure payment of the registered capital.

The content of the subsequent provision Section 119 of the Commercial Code, which regulates a change of the originally multi-member company to a single-member one is also focused on the obligation to pay up the investments. When following the establishment of a multi-member company, the number of its members falls to such extent that this company changes into a single-member one, the provision of Section 119 of the Commercial Code protects the legal certainty of third persons and lays down an additional deadline, in which the single member is to decide whether he will
extend the number of members of the company by a transfer of a part of his business share or whether he will pay up the remaining monetary investments (the non-monetary investments have to be fully paid up before incorporation of the registered capital with the Companies register according to the provision of Section 59 par. 2 of the Commercial Code).

Another group of Directive, which we mentioned at the opening, included Directives on mergers and divisions of trading companies. Requirements of the Directive regulation are once again focused in particular on joint stock companies. Nevertheless, other forms of companies cannot be excluded from their application because transformations often affect several companies of various forms. The Czech legal regulation of this area has experienced complicated development, whose current result is Act No. 125/2008 Coll., on Transformations of Trading Companies and Cooperatives, which regulates the said processes with all forms of trading companies known in the Czech law and which applies also to cooperatives. The Act kept the reached standard of harmonization. As against the existing regulation in the Commercial Code, however, it includes significant simplifications of the system as well as procedure upon transformations. The regulation of Act No. 125/2008 Coll. shall be applied to single-member as well as multi-member limited liability companies. Detailed analysis of individual transformations exceeds the scope of this paper.

4. Conclusion

The predominant and decisive portion of the valid legal regulation of the limited liability company in the Czech law corresponds to the standard anticipated by the European Directives. If some portions of the legal regulation have not been harmonized, only partial elements are concerned, which are not decisive in terms of the complex legal regulation.

Other changes provoked by requirements of the Directives may be expected only in connection with a reform of the whole law of trading companies within the European Community, whose initial results can be seen in partial amendments of certain Directives.

The newly adopted standards are focused rather at simplification of the legal regulation, removal of direct orders and prohibitions and strengthening indirect forms of regulation, which emphasizes autonomy of will of the entities (increased importance of information and its availability, support to regulation of internal relations in companies in memoranda of association and articles of association). Hence the clasp of regulation of the limited liability companies and the joint stock companies, which is considerable in the Czech legal regulation and which may represent an unnecessary administrative burden on limited liability companies might not be perceived as a negative. A positive example of this clasp it the possibility of financial assistance as it is proposed these days, which is to allow entry of new investors even to the limited liability companies.

Instead of substantial changes provoked by the Directives, one may expect rather pressure on simplification of the limited liability company regulation caused by competition of legal systems (statute shopping), in which the founders choose for the personal status of their trading company the legal system of such state of the Community, which suits them the best in terms of the costs of incorporation and administration of the company. Mutual collisions of legal systems of individual Member States may very considerably affect the development of legal regulation in each of these states and result in absolutely unconventional legislative solution. Also in this respect, investors look for legal regulation in such state where the system of legal regulation allows saving of costs. It is a question that will have to be discussed in detail in close future whether these tendencies will not lead to a reduced standard of protection of third persons.

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4 Judgment in C – 411/03 SEVIC Systems AG.

5 Second Council Directive No. 77/91/EEC on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty (today Article 48 of the Treaty), in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent. This Directive was amended by the Council Directive No. 92/101/EEC and

6 For details on this issue see DEDIČ, J. A KOL., Obchodný zákoník, komentář [Title in translation: Commercial Code, Annotation], Part I, Polygon, Praha, 2002, p. 959 et seq.


8 Ibid., p. 522.


12 An example may be the development in Germany where the scope of use of the legal form of the English Private Limited Company about a radical reform of legal regulation of the German GmbH (Gesellschaft mit beschränkter Haftung). See for example the articles RÖMERMANN, V., Der Entwurf des „MoMiG“ – die deutsche Antwort auf die Limited, GMBHRundschau 2006, No. 13, p. 673 and WESTHOF, A. O., Die Verbreitung der englischen Limited mit Verwaltungssitz in Deutschland, GMBH 2007, No. 9 p. 478.