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THE ISSUES 2012

UPCOMING LEGAL TOPICS IN THE CZECH REPUBLIC

CMS Cameron McKenna

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January 2012

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Welcome

Welcome to 2012: The Issues!

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I am pleased to welcome you to *2012: The Issues*, our publication introducing you to some of the approved or planned legal changes in the Czech Republic in the upcoming year.

The articles on the following pages will touch upon a wide array of legal changes in 2012 that might affect your business. Some of the changes have come into effect at the start of this year, others are expected to come into force later in the year, and others are still in the stage of parliamentary discussion. Some may open up new business opportunities; others may make the business environment more regulated in favour of other interests.

A number of the recent amendments such as those to the Commercial Code, the Labour Code or VAT Act are relevant for every business in the Czech Republic. Others like the New Renewable Energy Act or the Electronic Communications Act are more specific to a particular sector or industry.

The articles in this publication reflect the sector driven structure of CMS. As a firm we have chosen to organise ourselves in the way our clients see their own business. Therefore in addition to the 'traditional' practice groups such as Corporate/M&A, Commercial Regulatory and Disputes, Real Estate, and Banking, our lawyers are organised in sector groups providing added value to clients through their years of experience advising businesses just like yours.

2012: Fresh look for Transformation Act

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The extensive Amendment to the Act on Transformations of Corporations and Cooperatives, No. 125/2008 Coll., (the 'Act') came into force on 1 January 2012 and will remove a large number of deficiencies and ambiguities in this often criticised piece of legislation.

New regulation of the decisive date

The decisive date is a date from which the actions of (i) dissolving company or cooperative, (ii) dissolving companies or cooperatives, or (iii) a company or cooperative undergoing division are considered, from an accounting perspective, as actions taken on the account of the successor companies , cooperatives or a shareholder taking-over. The concept as such remains unchanged.

The greatest practical changes result from a reworked concept of the decisive date. The decisive date is a point in time associated with a number of obligations, such as the opening of the balance sheets of successor companies, preparation of financial statements, and calculation of expert valuations or share or business share exchange ratios. These should all be prepared as of the date preceding the decisive date. Typically, the decisive date is 1 January, financial statements are prepared as at the date preceding such date, i.e. as at 31 December of the preceding year. The opening balance sheet of a successor company is prepared as at the decisive date.

The occurrence of the decisive date will now be possible no sooner than after completion of a transformation project or even after approval of a transformation project. The new ultimate milestone for determination of the decisive date will be the date of registration of transformation in the Commercial Register.

The concept of the decisive date differs across EU member states. If, in practice, a cross-border merger brought together companies from different member states, with different regulation of the decisive date, there were questions whether the transformation was feasible at all and if so, according to which national regulations the decisive date was to be determined.

Cross-border transformations in more detail

The amendment introduces a detailed regulation of cross-border transformations, including a cross-border relocation of registered seat and removes doubts as to whether some types of cross-border transformations are feasible or not.

The extensive amendment deals with all types of transformations with a foreign element in great detail. It will now be possible to split off part of assets abroad, e.g. machines to Poland or cars to Cyprus. The Act now also allows for the split of a company to the Czech Republic and abroad and/or to relocate the registered office of a Czech company e.g. to Slovakia or to Germany without any necessity to govern the legal relations within the company according to the Slovak or German law. The internal status of the company under the Czech law will be preserved.

The amendment further regulates the possibilities of a change of shareholder in the process of transformation and now expressly allows such change, or regulates the methods of disclosure of information about transformation, when the companies can publish such information on their corporate internet websites.

Rights of pledge

The Act now provides greater protection to pledges, e.g. by an 'upwards' corporate merger i.e. a merger of a subsidiary into a parent. Protection will now be provided to pledgees in the form of adequate security.

The amendment deals with the issue of further pledging of an already pledged security. The Act expressly allows the possibility of double pledging, but does not contain any rules governing the execution of simultaneous rights of pledge.

After the amendment it will be obvious that in the event of more pledges becoming attached to one business share or share, pledgees will be satisfied proportionately. If there are more pledgees, the pledged certificated share will be delivered to a pledgee who is to be agreed by all pledgees. If the pledgees fail to agree within a reasonable period after the company's call, the company itself will deliver such security into custody at the expense of the pledgees.

Between the lines of the Commercial Code

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On 1 January 2012, the Amendment to the Commercial Code came into force. It provides for changes to a variety of issues such as: concurrence of members of a statutory body with an employment relationship; legal title to premises used for the purpose of a registered seat; financial assistance by joint stock companies; and alienation of property which had originally been acquired against the rules set out in Article 196a.

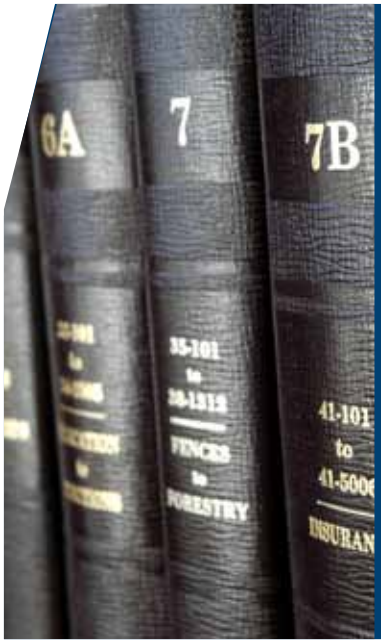
However, hidden between the lines of the Amendments is one of the most important changes it introduces: the possibility to agree on the limitation of liability for damages in the event of a breach of contract.

The Czech Parliament has approved an amendment of the Czech Commercial Code ('Commercial Code') which will remove the statutory prohibition of contractual limitation of liability relating to claims on compensation of damage prior to the occurrence of the damage.

Under the new wording of the amended part of the Commercial Code it will be possible, in relationships governed by the Commercial Code, to agree on a waiver or limitation of liability for damages prior to the occurrence of the damage, i.e. before an obligation from which damage may arise is breached. This would not, however, apply to any breach or damage caused intentionally.

The amendment reflects long-standing discussions on the possibility to contractually limit or even exclude liability. Until now, neither Czech case law nor Czech jurisprudence has ever provided a consistent and clear answer on how to deal with these matters of law. Due to contradictory decisions made by the Czech Supreme Court regarding this issue, it is unclear whether the parties could agree to the limitation of one party's liability for damage incurred to the other party by or in connection with the performance of their duties under their contract. By limiting the potential claim to compensate damage the contractual parties put themselves at risk that such provisions in their contract shall be invalid. Unlimited liability has represented serious uncertainty for doing business in the Czech Republic and was capable of complicating major transactions.

The Amendment to the Commercial Code will bring the Czech legal system closer to European legal standards and will increase flexibility for both foreign and Czech entrepreneurs. The extent to which it will be possible to limit the liability in future will, however, have to be carefully assessed in each individual case. Parties to commercial contracts governed by Czech law will have to be cautious while negotiating limits of their liability and have to carefully assess the potential impacts on their businesses in case such damage indeed occurs in the future. It will be also important to see how Czech courts will assess the limitations of liability, in particular in cases where an agreement would provide for absolute exclusion of potential future liability for damage of one of the parties to the contract.



New Act on criminal liability of legal entities

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In December the Chamber of Deputies overruled the President's veto of the governmental bill regulating criminal liability ('The Law') of legal entities. The Law came into force on 1 January 2012 and will introduce significant changes regarding the liability of companies.

Previously, legal entities were not subject to criminal law; rather the liability of legal entities had been governed by administrative law. As of this year, legal entities are, similar to individuals, liable for committing specific crimes.

The Law specifies circumstances under which legal entities may be criminally liable. Legal entities will be primarily liable for any crimes committed on behalf, in the interest of or within the scope of their activities. Such crimes must be committed by:

— (member of) the governing body or any other person authorised to act for or on behalf of the legal entity;
— any person exercising managing or supervisory activities within the legal entity, although not being a person mentioned above;
— any person exercising a decisive influence upon the management of the legal entity provided that the conduct of such person constitutes at least one of the conditions for the rise of consequences resulting in the criminal liability of the legal entity;
— any employee or person in a similar position while performing their working duties, although not being any of the persons mentioned above.

However, not every conduct of persons mentioned above will be attributable to the legal entity. The committed crime will only be attributable to the legal entity if committed by:

— the legal entity's bodies or the afore-mentioned persons;
— an employee based on a decision, approval or instruction of the legal entity's bodies or of persons mentioned above or if the persons mentioned above (including in particular the legal entity's bodies) fail to take any steps they should take according to another legal regulation or steps they may reasonably be required to take, in particular if they fail to make any mandatory or necessary inspections of the employees' activities or activities of other persons that are subordinate to them or if they fail to take any necessary measures to prevent or avert the commitment of a crime.

If such criminal conduct is not attributable to the legal entity, the respective individual will be liable for his/her own conduct. The Law also provides for concurrent proceedings against a legal entity and the respective individual.

The legal entity will not avoid criminal liability in case of a conversion (such as merger) or if it relocates its registered office. Criminal liability will pass on to the companies' legal successors without any exceptions.

Legal entities may only commit crimes listed in the Law (around 80 crimes), which would most frequently be property crimes, economic crimes, environmental crimes and various types of bribery and corruption.

Criminal proceedings will be governed by the Criminal Procedure Code, unless the law stipulates otherwise.

The following penalties may be imposed upon legal entities for the committed crimes:

— Winding-up of the legal entity
— Forfeiture of property
— Monetary penalty
— Forfeiture of individual asset or other property value
— Prohibition to exercise the respective activities
— Prohibition to take part in award or concession procedures and in public tenders
— Prohibition to accept any donations or subsidies
— Publication of a judgment in public media

Similar to the criminal register of individuals, there will be a criminal register of legal entities keeping records of any crimes committed by the respective legal entity.

To eliminate criminal liability, companies should set out clear rules regarding the specification of tasks and authorisations of the respective employees or persons authorised to act for the company, introduce a transparent system of giving and documenting instructions and consistently supervise persons employed by the company.

Acceleration of criminal proceedings? Agreement on guilt and penalty

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In December 2011, the Chamber of Deputies discussed a new Amendment to the Criminal Procedure Code introducing a new institute called an 'agreement on guilt and penalty'. This institute has already been implemented in many European countries, such as Germany, Italy and Slovakia. The primary goal of implementation of the agreement on guilt and penalty is to accelerate criminal proceedings in certain cases.

The agreement on guilt and penalty has to be concluded between the prosecutor and the accused person, if the investigation proves that: (i) the concerned act has happened; (ii) that such act is a criminal act; and (iii) it was committed by the accused person. In order to conclude the agreement on guilt and penalty, the accused person has to admit to being guilty and must agree with the suggested penalty. The agreement on guilt and penalty may then be approved by a (criminal) court. A court is not, however, bound by a proposed agreement and the agreement does not need to come into effect.

The agreement cannot be concluded in cases of particularly serious criminal acts, such as criminal acts against the Czech Republic, a foreign state and international organisations, or criminal acts against peace and humanity, or acts having intentionally caused death.

If passed by the Senate and signed by the President, the new amendment to the Criminal Proceedings Act should become effective as of 1 July 2012.

Increased flexibility on the labour market

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After long debates, the Czech Parliament finally approved a Governmental bill to amend the Labour Code. The new bill supports the position of employers who claim to suffer under the existing rigid measures in the Labour Code that protect stability of employment and legitimate interests of employees. Following the presidential approval, there have been no further obstacles for the bill to become effective as of 1 January 2012.

The most important changes to labour relations introduced by the bill include the following:

— **Probationary period**: In the future the maximum probationary period for managerial employees (those directly supervising other employees) will increase to six months. During this period the employer may terminate the employment with immediate effect without giving reasons;

— **Fixed-term employment**: The maximum length of a fixed term employment agreement will increase from two to three years which can be repeated twice (ie, in total nine years of fixed term employment shall be admissible) but the existing exceptions permitting a longer fixed-term will cease to exist;

— **Severance pay**: The severance pay entitlement of an employee that is dismissed for organisational reasons will change from three months' average earnings to a sliding scale one to three months' average earnings depending on the length of employment, and extending the entitlement to employees choosing to leave due to a material deterioration in their working conditions following the transfer of their employment to a new employer;

— **Immediate termination**: The compensation due to an employee terminating his employment with immediate effect (eg, as a result of not being paid) will change to the salary payable during his notice period rather than three months' average earnings;

— **Temporary assignment**: An employer will be entitled to second its employees to another company under a temporary assignment agreement without having to apply for a work-agency permit;

— **Overtime pay**: The new Bill allows employment agreements to require employees to work up to 150 hours of overtime without additional pay, and employment agreements for managerial employees to exclude pay for overtime work completely;

— **Holiday**: Employees will be free to choose the timing of their holiday where their employer has not allowed them to their annual holiday entitlement for a particular year by the end of June of the following year; right to holiday no longer expires if not taken in the following year;

— **Sick leave rules compliance**: Employers will be entitled to terminate employment by way of notice if an employee grossly violates the sick leave rules;

— **Non-compete**: The minimum compensation payable to departing employees agreeing not to compete with the employer's business activities for a year after termination of employment will be reduced to half of their average salary; and

— **Transfer of employees**: Under the new legislation employees can terminate their employment due to transfer as of the day which precedes the effectiveness date of a transfer without having to comply with their notice period; lowering consultation duties of employers in connection with a transfer.

It is important to note, that in order to comply with these changes it may be necessary to review your standard employment agreements or internal policies.

2012: start of a new VAT regime

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In early November 2011, the Lower Chamber of Parliament approved several amendments to the Act on Value Added Tax (the 'VAT Act'), thus overruling the Senate's prior dismissal of these amendments. The original so-called 'Rate Amendment' has subsequently been enhanced by further changes.

With effect from 1 January 2012, the reduced VAT tax rate of 10% has been increased to 14%. The standard (basic) rate of 20% remains unchanged throughout 2012. From 1 January 2013 the VAT rates will be harmonised at the same rate of 17.5%, without any exceptions. In other words the current reduced rate will increase from 14% to 17.5% and the standard rate will decrease from 20% to 17.5%.

The Amendment contains transitory provisions of major importance, particularly concerning the application of a correct tax rate in the case of taxable supplies and considerations taking place in 2011-2012 and 2012-2013 (e.g. supply of water, heat, cooling, electricity, gas, telecommunication services, etc.).

In practice, it will be necessary to approach the following situation with due caution: where taxable supplies become effective after 1 January 2012, but where the monetary consideration has been accepted before that date and therefore an obligation to declare tax arises for the recipient. For example, should an advance payment of CZK 88 (total price is CZK 100 excl. of VAT) be accepted in 2011 for a taxable supply under the reduced tax rate, the VAT declared from this advance payment will amount to CZK 8.8 (i.e., 10%). In 2012, the date of effecting the relevant taxable supply, a 14% rate of VAT will be applied, but only to the difference of the agreed price of CZK 100 (excl. VAT) and the accepted advance payment of CZK 80 (excl. VAT), i.e. CZK 20 will be taxed at the new rate of 14%.

The Amendment also contains a more benevolent and milder regulation of corrective tax documentation, namely the summary tax document does not have to contain specific references to particular numbers of the original tax documents. Where there is an error in the summary tax document it is sufficient to demonstrate a sufficiently determinable link between the original taxable supplies and the correction shall suffice: it will no longer be a requirement to show the tax document number of the original tax document. The summary tax documents are also related to the introduction of a new option: when converting a value in a foreign currency into Czech crowns, it is possible to use the exchange rate of the Czech National Bank that is valid on the first working day of the calendar year in which the reason for correction originated.

In an attempt to restrict tax evasion and fraud, the proposal broadens the doctrine of security for unpaid tax in a situation where a customer is obliged to secure the tax unpaid by the supplier only under the circumstance where the customer pays, entirely or in part, for the taxable supply by wire transfer to a bank account maintained outside the Czech Republic. The tax administrators are entitled to secure the payment through a securing order. The tax administrator may issue a securing order for tax which is not yet due or for undetermined tax where there is a danger of delay. This order becomes effective and enforceable immediately after being issued and not after notification to the taxable person (VAT payer).

In addition to the VAT Act also the Act on Regional Financial Authorities has been amended. As a result, on 1 January 2012, a specialised financial authority (*specializovaný finanční úřad*) has come into existence. This authority will deal with banks, insurance companies and legal entities with entrepreneurship as the purpose of their establishment and a turnover exceeding CZK 2,000,000,000. The seat of this new authority shall be in Prague and the territorial range of its powers covers the entire Czech Republic. The relevant financial authorities should hand over their files to this new organisation on their own initiative and shall also notify the taxable person in question.

New amendment to the Czech Arbitration Act

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On 2 January 2012 the President of the Czech Republic signed a new amendment to Act. No 216/1994 Coll., Czech Arbitration Act (the "new amendment"). The new amendment will become effective in spring 2012.

As a consequence of several recent decisions of the Czech Supreme Court and the Czech Constitutional Court regarding arbitration clauses in B2C relations, most of the proposed changes aim to strengthen the position of consumers in arbitrations. The main proposed changes are as follows:

- Arbitration agreements in relationships between businesses and consumers must be explicit and must be drawn up as a separate agreement to the main contract (including any business terms and conditions);
- Arbitration agreements in relationships between businesses and consumers must include information on the arbitrator(s) or that the dispute will be resolved by a permanent arbitration court, the manner of commencement and form of conducting of the arbitration, the arbitrators' fees and expected expenses of arbitration and the manner of their payment and adjudication, the place of arbitration, the manner and form of the delivery of the arbitral award and information that the award is enforceable;
- The business/entrepreneur will be obliged to explain in detail to the consumer what the consequences of entering into arbitration agreement may be;
- An arbitrator in consumer disputes must meet stricter requirements (an arbitrator must have a university degree and he/she must be enrolled in the public list of arbitrators for resolving consumer disputes maintained by the Ministry of Justice of the Czech Republic);
- Arbitrators in consumer disputes are obliged to inform parties whether, in the last three years, they have been involved in a dispute regarding one of the parties;
- Arbitrators in consumer disputes cannot make decisions according to equitable principles;
- A civil court may annul the arbitral award if
  - A consumer's dispute is decided contrary to good moral principles or contrary to Czech public policy;
  - An arbitration agreement does not contain all of the necessary information (mentioned above).
- If a consumer asks to defer the enforceability of an arbitral award (while asking for the annulment of arbitral award), a civil court has seven days to make a decision (during this period the arbitral award is not enforceable).

Czech Republic: Restricted anonymity for bearer shares

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In the future bearer shares in joint stock companies will either have to be registered with a central depository or physically deposited with banks, under proposals announced by the Ministry of Justice.

Both alternatives will require the owner of the share to be identified to the central depository or bank, and the information will then be available to specified public bodies (such as the police and those awarding public contracts or providing subsidies).

They also require any transfer of ownership to be subject to a change of registration with the central depository or the bank, to ensure the register remains up to date.

The legislative changes, which are planned to appear in the Act on Corporations, are aimed at combating a lack of transparency in the ownership structure of joint stock companies with bearer shares.

The Act is unlikely to become law before 2013 and will probably then provide a further 18-month period from the date of its coming into force for joint stock companies to convert bearer shares into registered shares or 'immobilized' in bank depositories.

Bearer shares are permitted under Czech law but their holders (especially of materialised bearer shares) may not only be unknown to the company but also be unidentifiable for state authorities (for criminal, tax or other purposes).

Ownership of materialised bearer shares is currently transferred with possession, in the same way as handing over a banknote. This is not true for registered shares, whose holders are easily identifiable from the share certificate or the company's register of shareholders.

The Ministry's approach is not to abolish bearer shares, as anyone wishing to remain anonymous could still register a 'dummy shareholder' as the registered owner, but to restrict the anonymity the holders enjoy in order to combat money launderers and those seeking to circumvent the Conflict of Interests Act, especially in relation to public contracts.

Consumer Products

Strengthening consumer rights: New EU Consumer Rights Directive

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On 10 October 2011, the EU's Council of Ministers formally approved the draft new EU Consumer Rights Directive, which shall be subsequently published in the Official Journal. The directive has been introduced to reinforce consumer rights, in particular in terms of online-shopping.

The new Directive shall replace two older EU directives, which have been implemented in the national laws of the Member States including the Czech Republic. The new regulation aims to fully harmonise the conditions on the EU market. The times when individual Member States were entitled to adopt stricter rules protecting consumers seem to have come to an end. As a result, another obstacle for businesses on the internal market will be lifted.

Increased price transparency can be seen as one of the main goals of the new directive, which aims to protect consumers from 'cost traps', frequently encountered especially in online shopping. From now on, traders have to disclose the total price payable for a product or service as well as any additional fees. On-line horoscopes, where it is not clear that the service is paid until having filled in a long form and pre-ticked boxes concerning additional services for flight passengers, which may increase the price if not having been noticed and un-ticked, are no longer admissible.

The new regulation follows the principle that a consumer has the right to change his mind in the case of distance or off-premises contracts. The time period for withdrawal from such agreement has been extended to 14 days from delivery (the authors of the directive may have found inspiration in the Czech law where this period already applies).

The right to withdraw from the agreement also applies to contracts for the provision of services. If the consumer agrees that the performance of the service should start during the 14 days withdrawal period, he will still be able to withdraw from the agreement, however, he will have to reimburse the trader on a pro-rata basis for any costs incurred in relation to the provision of services.

Every consumer has the right to be informed about the option to withdraw from the agreement and. if the trader fails to notify him, the return period is automatically prolonged to one year. Following such a withdrawal, for which a new EU-wide standard form will be introduced, the consumer will only have to bear the costs of returning the goods if he was made aware of these costs in advance.

The Directive also includes a time period in which the price of the returned goods has to be paid back to the consumer after withdrawal. While under the current Czech regulation, this period amounts to 30 days, the new EU regulation introduces a period of 14 days. In most cases it is the trader who bears the risk of the goods being damaged during the return transportation.

Other provisions which protect the consumers from additional costs include rules based on which the trader is not entitled to charge any extra fees for credit card payments, which exceed the costs sustained by the trader as a result of this payment method. Similar rules apply to surcharges for telephone hot-lines: if a consumer needs to contact the trader in relation to the fulfilment of the contract, he cannot be charged a higher price than the basic rate for phone calls.

The new Directive also governs the delivery of the products. In order to avoid cases, where there is a large time gap between order and delivery and the consumer may change his mind about buying the ordered goods, it introduces a time limit of 30 days following which the consumer can withdraw from the agreement.

Further changes concern, among others, information duties of the traders. As the new directive introduces additional red tape, it also includes cases of minor business-to-consumer contracts where the consumer protection regulation does not apply.

The Member States have to implement the Directive in their local legal system within two years after the directive is published in the Official Journal of the EU. Although a new Czech civil code is proposed to be adopted and be effective from 2014, it seems that the current Civil Code will need to be redrafted to comply with the regulation. Once the new regulation is implemented, most of the traders in the Czech Republic and the other EU Member States will be forced to amend their standard sales agreements and general terms and conditions of sales in order to comply with the new regulation. Once the Czech implementation becomes effective, every trader who does not follow the rules can be investigated by the Czech Trade Inspection Authority or other competent bodies and risks being fined.

Energy & Utilities

Amendment of the Energy Act

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The implementation of the Third EU Energy Package into the Energy Act by Act no. 211/2011 Coll. effective from 18 August 2011, introduced, amongst others, new rules concerning the operation and construction of electricity generating power plants, enhanced protection of customers and increased power of the Energy Regulatory Office (the 'ERO').

The most important changes introduced by the act that have a significant impact on the operation and construction of electricity generating power plants include the following:

— **Dispatching operation**: Operators of electricity generating power plants with an output of over 100 kW must equip the power plants with devices allowing for the 'dispatching operation' of the facility by the grid operator.

  Power plants with an output of 100 kW up to 2 MW must be equipped with such devices by 30 June 2013, whilst power plants with outputs of 2 MW and above must be equipped with such devices by 30 June 2012.

  This obligation does not apply to renewable energy power plants with an output of up to 10 MW put into operation before 2000 and small water power plants with an output of up to 10 MW.

— **State authorisation**: Construction of electricity generating power plant with an output of over 1 MW is now subject to a state authorisation by the Ministry of Industry and Trade. The authorisation shall be granted based on an analysis of compliance with, amongst others, the National Energy Policy, National Renewable Energy Action Plan, grid development plan and impact on the secure and reliable operation of the grid. The requirement of state authorisation applies to all electricity generating power plants for which the zoning proceedings were not initiated before 18 August 2011.

Furthermore, the Amendment introduced other important changes with respect to the electricity market:

— **Protection of customers**: New provisions to strengthen consumer protection, such as enabling customers to change supplier if conditions or prices of electricity or gas have been altered by the supplier, and requiring suppliers to provide customers with certain information.

— **Powers of the ERO**: Stronger powers and duties were given to the ERO with respect to the certification of the independence of the transmission and distribution system operators and with respect to the protection of customers' rights.

Act on Supported Sources of Energy

Following the approval by the Lower House of Parliament on 9 November 2011, it is likely that a new Act on Supported Sources of Energy (the '**Act**') will be adopted early 2012. The Act will replace the current Act on Promotion of Use of Renewable Sources and will become effective from 1 January 2013 (with the exception of several provisions which will become effective later).

The most important changes introduced by the Act in the wording approved by the Lower House include the following:

— **New agreements**: The operator of an electricity generating power plant will need to enter into a new agreement on the supply of electricity with a feed-in tariff or new green bonus agreement with the market operator. The existing agreements with the grid operators expire on 31 December 2012. However, save for this obligation, the conditions of support of existing electricity generating power plants remain intact.

— **Market operators**: The Act anticipates a new method of support payment. The Act allows for the authorisation of two or three market operators to support the purchase of electricity produced from renewable resources. These operators shall also act as last resort purchasers. This mechanism replaces the current scheme where support is being paid by the grid operators.

— **Unification of conditions**: The Act unifies the support provided for the production of electricity from renewable energy sources, production of heat from renewable sources and combined production of heat and electricity.

— **Green bonuses**: The Act introduces a new concept of energy buy-out, which significantly modifies the current feed-in tariffs/green bonuses with preference being given to green bonuses. The Act also stipulates that the ERO shall set the conditions for electricity support so that the feed-in tariff or green bonus does not exceed CZK 4,500/MWh. This will apply to new sources only.

— **National Renewable Energy Action Plan**: The National Renewable Energy Action Plan will be decisive for the support of electricity production, which allows the government to regulate the energy sector. Some experts claim that the National Renewable Energy Action Plan allows for the limitation or termination of support for some sources and the preference of others.

— **Support for biomass only for co-generation**: Power plants producing electricity from biomass will only be entitled to support highly effective combined production of heat and electricity.

— **Solar tax maintained**: The heavily criticised solar tax, which is the subject of a constitutional claim at the time of writing, has been retained in the Act without substantial changes.

— **Solar panel waste disposal**: The Act introduces new rules concerning the financing of solar panel waste disposal. The operator of a solar power plant will be responsible for financing the waste disposal of solar panels marketed before 1 January 2013.

— **Termination of reimbursement for dispatching operations**: The Act removes the provision of the Energy Act under which the grid operator's dispatching centre has to reimburse the supplier for limiting its supplies of electricity to the grid.

Financial Services

Major pensions reform in the Czech Republic: Creating a three pillar system

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On 6 November 2011, the Lower Chamber of Parliament approved by a qualified majority the introduction of new laws significantly reforming the Czech pension system. To finally approve the Bills, the Lower Chamber had to overturn a previous decision by which the Upper Chamber had rejected the bills in October 2011. Even though the President decided not to sign the bills, he also decided not to veto them. As a result, the new laws successfully passed through the whole legislative procedure.

The new laws introduce the most significant reform of the Czech pensions system since the communist regime collapsed in 1989. The pensions reform will come into effect as of 1 January 2013, however specific provisions allowing establishment of new pension fund companies will come into effect in 2012.

Currently, the pension system is mostly based on the mandatory pay-as-you-go system and supplementary schemes with state contribution. Based on the new laws, the current pay-as-you-go system (I. pillar of the pension system) will be supported by a newly created II. pillar, and the current supplementary schemes with state contribution will be transformed into a III. pillar.

The new II. pillar will be based on the principle of pensions funds. Entry into the II. pillar will be voluntary: each participant to the pay-as-you-go system will have to choose, before reaching the age of 35, whether to join the II. pillar. Participants who will be older than 35 years of age on 1 January 2013 will have six months to decide whether to join the II. pillar. Upon a decision to join the II. pillar, part of the mandatory payments made so far by the participants to the pay-as-you-go system will be redirected to the II. pillar. In practice, participants to the II. pillar will still have to remain participating in the pay-as-you-go system (I. pillar). The decision to join the II. pillar will be permanent; participants will not be able to exit the II. pillar.

The III. pillar of the pension system will be created by a substantial reform of the current supplementary schemes with state contribution. The current supplementary schemes with state contribution will be converted into so-called transformed pension funds and will not accept any more new participants. In parallel, a new type of III. pillar supplementary fund with state contribution will be created. The participation in this new type of III. pillar supplementary funds will be voluntary and will be allowed in addition to participation in the I. pillar and II. pillar. In contrast to the II. pillar, participants will be allowed to join and exit the III. pillar at any time. Participants can join a III pillar fund after they reach the age of 18 years.

The administration of both the II. pillar and III. pillar funds will be handled by pensions fund companies which will be created either by the transformation of the currently existing pension funds providing supplementary pension insurance with state contribution, or by establishing completely new pension fund companies. Each pension fund company will have to obtain a special licence for its activities within the II. pillar and/or the III. pillar from the Czech National Bank. Each II. pillar pension fund company will have to offer four types of pension funds (with different investment limits, portfolio structure and associated risk): a standard pension fund; a conservation pension fund; a balanced pension fund; and a dynamic pension fund. Each III. pillar pension fund company will have to offer at least one conservation pension fund; other types of funds can be offered by the III. pillar pension fund company depending on its business strategy.

The pension reform will offer significant business opportunities for existing life insurance companies and new market entrants. Life insurance companies may benefit because, having reached retirement age, participants to the II. pillar and some participants to the III. pillar will receive payments via pension insurance policies concluded with insurers duly licensed to provide such type of life insurance in the Czech Republic. In addition, the pension reform will bring new business opportunities for banks who will be allowed to act as depositories for both the II. pillar and III. pillar pension fund companies, and for various types of intermediaries (such as capital markets brokers etc.) who will be allowed to act within the distribution channel for the new products generated by the II. and III. pillar pension fund companies.

Lifesciences

Current issues in lifesciences

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The lifescience sector is driven by development and innovation. In its quest to improve our overall quality of life it is always pushing the existing boundaries, both of science and of the legal framework that regulates the sector. This article covers new regulation as well as current trends and issues in the field of pharmaceuticals and health products.

Regulation of sale of pharmaceuticals on the Internet
The sale of various types of pharmaceuticals products over the internet has been rising in the last couple of years. Because of their specific nature, their sale has to be strictly regulated by law in order to prevent any potential harm to human health.

Based on its distribution manner, pharmaceuticals purchased in the Czech Republic can be divided into two basic categories. The first category is non-prescription pharmaceuticals, which can be bought freely; the second category is prescription pharmaceuticals, which have to be prescribed by a doctor to allow a person to buy them.

The non-prescription pharmaceuticals can be bought or sold without restrictions and selling them over the internet is not prohibited in the Czech Republic. However, the respective e-shop can only, in fact, be operated by a real instore shop. In other words, 'virtual' e-shops selling non-prescription pharmaceuticals are prohibited under Czech law. Also the sale of prescription pharmaceuticals via the internet is not allowed in the Czech Republic.

Following the alarming increase of medicinal products detected in the European Union which are falsified in relation to their identity, history or source, a new EU Directive was adopted in June 2011.

The EU Directive newly requires the EU member states to adopt a respective legal regulation regarding the sale of pharmaceuticals over the internet in order to prevent falsified medicinal products entering the market. Such legal regulation might also be the first step in setting down the rules for online pharmacies that offer prescription as well as non-prescription pharmaceuticals.

In this regard the Czech Government has also promised to deal with falsified medicinal products being marketed on the internet and will propose to amend the Czech Criminal Code and introduce new types of crimes regarding the falsification of drugs.

Intellectual property rights and pharmaceutical products
Just as other innovative products, pharmaceuticals can also be protected by intellectual property rights, in particular by trademarks, and even more importantly, by patents.

Pharmaceutical products are eligible for patent protection as long as the general criteria of patentability are met (i.e. novelty, inventive step and capability of industrial application). While general patent protection lasts for 20 years (from the filing date), holders of patents granted for medicinal products may also apply for a so called Supplementary Protection Certificate (SPC). The purpose of the SPC (an initiative of the EU legislators incorporated in Regulation No. 1768/92 repealed by Reg. No. 469/2009/EC) is to balance out the lengthy process connected with pharmaceutical research and to guarantee sufficient protection for the development of medicinal products in the European Union. Experience has shown that the period between the filing of a patent application for a new medicinal product and the actual authorisation to place the product on the market significantly reduces the effectiveness of the patent protection afforded to medicinal products. In effect that may seriously compromise the ability to refund the financial and time investment put into pharmaceutical research. Such legal, and eventually also economical uncertainty, may naturally force research institutions originally based in the Member States to relocate to countries offering better protection (e.g. USA or Japan).

Therefore, to ensure longer and more effective protection of pharmaceutical (medicinal) products, the respective patent holder may apply for a SPC which may prolong the protection of the original patent for up to a maximum of five years. As a general rule, the duration of protection afforded by a patent and by the certificate (together) cannot exceed 15 years overall for the patent holder's first marketing authorisation.

In order for a medicinal product to be eligible for the SPC protection, four main criteria must be met:
— the product is protected by a basic patent which is in force;
— the product, as a medicinal product, has been granted a marketing authorisation;

— the product has not already been the subject of a certificate;
— the marketing authorisation is the first authorisation to place the product on the market as a medicinal product.

For this purpose a 'medicinal product' shall mean an 'active ingredient or combination of active ingredients'.

As much as the above four requirements may seem straightforward, the practice has shown that problems may arise in the event that patent protection has been granted for a single ingredient only, while market authorisation has been granted for a combination of multiple ingredients (typically vaccines). Fortunately for the producers of pharmaceuticals, the Court of Justice of the European Union has recently (on 24 November 2011) handed down a landmark decision in which it clarified the scope of protection afforded by the SPCs. The Court based its decision on the examination of the objectives of the SPC regulatory framework (to encourage pharmaceutical research) and concluded that an SPC may be obtained for an active ingredient specified in the patent claims, even if it co-exists with other active ingredients contained in the medicinal product for which marketing authorisation has been granted (Medeva & Georgetown University v UK Patent Office; Case no. C-422/10).

As soon as patent and SPC (if applicable) protection has expired, producers of generic pharmaceuticals are free, subject to strict supervision and quality control measures, to produce and put on the market their own (generic) products using the same active ingredient(s) as the original medicinal product. Generic pharmaceuticals must have the same active substance (both in terms of quality and quantity), but must be placed on the market under a different product name (i.e. the original name, usually protected by a trademark, may be used by the original producer only).

Since manufacturers of generic pharmaceuticals do not have to invest large amounts into medical research and into obtaining patent protection, the production and ultimately the price of a generic pharmaceutical would be about 20 – 80 % cheaper than the original product.

An interesting fact – the years 2011 (particularly the last quarter) and 2012 shall be critical in terms of drug patents expirations. That could mean a significant decrease in profits for patent holders (original producers) and, on the other hand, new business opportunities for the producers of generics.

Health claims presenting on food supplements

The sale of food supplements has grown significantly in the past years and customers sometimes confuse food supplements with pharmaceuticals. Under Czech law, food supplements are considered to be food and as such can only contain health claims which comply with specific food legal regulation.

Health claims must be approved by the European Commission before they are introduced in the label (or, indeed, any advertisement) of food supplements. Labels of food supplements must contain a statement indicating the importance of a varied and balanced diet and a healthy lifestyle, the quantity of the food and pattern of consumption required to obtain the claimed beneficial effect, a statement addressed to persons who should avoid using the food (where appropriate), and an appropriate warning for products that are likely to present a health risk if consumed excessively.

Health claims can be divided into two groups. The first category of health claims are presented by health claims referring to the reduction of disease risk (so called 'hard health claims'). Such health claims have to be individually reviewed by the European Commission. The list of 'approved' health claims shall be published by the European Commission.

The second category is represented by health claims other than those referring to the reduction of disease risk (e.g. referring to the role of a nutrient or other substance in growth, development and the functions of the body). These also have to be authorised by the European Commission but the review procedure is primarily done by national authorities.

Even though the EU Regulation setting out the above approval proceedings rules became effective from 1 July 2007, the list of health claims has not been published yet.

Therefore, the approval procedure assumed by the EU Regulation itself represents quite a big risk to all producers of food supplements and potentially for customers as well. Last but not least, the European Commission's practice might also represent a loss of profits for food supplements producers because it is hard to predict when the expected list will be complete.

[1] Directive 2011/62/EU of the European Parliament and of the Council dated 8 June 2011.
[2] Regulation (EC) No 1924/2006 of the European Parliament and of the council of 20 December 2006 on nutrition and health claims made on foods

Hotels & Leisure

Smoking ban proposed

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Following the trend in many European countries, Czech society is slowly turning against smoking in public places. Parliament is also following this trend, where a new bill to ban smoking in restaurants is being discussed. Entrepreneurs are protesting and threatening to shut down their businesses, but the majority of the general public agrees.

According to a recent public opinion poll, about 70% of Czechs are in favour of a smoking ban – four years ago, the same view was shared by only half of the population. Among smokers, one third approves of the ban, compared to 13% in 2007. The news spread from countries like France, Spain and Great Britain, where smoking bans were successfully introduced, and the changing atmosphere in Europe does have an impact in the Czech Republic as well. When the issue was raised in Parliament two years ago, the current legal framework was approved, in which all restaurants can choose to be either non-smoking, combined or smoking, and must be labelled accordingly. Although the bill from 2009 included some restrictions towards smoking in public places, a full-scale ban on cigarettes in restaurants did not find broader approval. However, things have changed substantially since then, and the new bill has found more champions than ever before.

The new legislation is supported by both the Prime Minister and the Health Ministry. It includes a variety of changes which will take gradual effect, the first step being a measure preventing children under 18 from entering places where smoking is allowed. A full-scale smoking ban in restaurants is drafted to apply in 2014. The plan has drawn opposition from restaurant owners and other stakeholders in the business, which would prefer that the current framework is adjusted rather than replaced with rules that threaten to discourage their customers. A survey carried out among 750 restaurant owners published by the Hotels and Restaurants Association of the Czech Republic (AHR ČR) showed that 71% consider the ban as 'interference into the freedom of their business.' The president of AHR ČR has stressed the adverse effects of the ban, such as hundreds of restaurants turning into 'smokers' clubs' or building smoking terraces to avoid the strict rules. The vice president of the Czech Confederation of Commerce and Tourism (SOČR) has expressed concern that more restaurants will close down every year because of a growing lack of customers.

The economic results of such measures are the subject of many debates. Surveys ordered by the tobacco industry show that restaurants lose money when they are forced to become non-smoking; other studies – and recent data from countries like Great Britain – show otherwise. But no matter how strong these arguments may be, the general public is slowly turning their back on smoker-friendly restaurants. The latest attempt to curb smoking in the Czech Republic is likely to succeed, but even if it does not this time, the trend shows that restaurants will most likely face the issue sooner or later in any event.

Current regulation:

— All restaurants shall decide and visibly label whether they are smoking, non-smoking or combined. Those combining smoking and non-smoking premises must be divided by a construction (specifications of which are subject to discussion). Restaurants allowing smoking must obey stricter engineering regulations (technical norms related to air conditioning and ventilation).

Proposed changes and schedule:

— The bill should enter the Parliament after being discussed with the Health Ministry no later than January 2012.
— Minors under the age of 18 will not be allowed to access premises where smoking is allowed (such as smokers clubs).
— Smoking shall be prohibited in all restaurants (including bars, cafes etc.) - effective from January 2014.

TMT

What to expect from the amendment to the Act on Electronic Communications?

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In a second voting the Chamber of Deputies approved the Amendment to the Act No. 127/2005 Coll., on Electronic Communications which aims to bring Czech law in line with European directives. The Chamber of Deputies initially approved the bill at the end of September of last year, however on 26 October the Senate referred it back to the Chamber of Deputies for further amendments. In December it was approved by the Chamber of Deputies and signed by the President. The changes open the door to new business opportunities and offer increased consumer protection.

New business opportunities

In the future, the Czech Telecommunications Office (ČTÚ) will grant authorisations for the use of radio frequencies. The amendment will provide for an auction sale of frequencies that have become available after the transfer to digital broadcasting. The radio frequencies will be granted to successful bidders for a maximum of five years. The ČTÚ will require operators to guarantee a minimum quality of service. The conditions of participation in an auction cannot prevent other big operators entering the Czech market and can thus have a substantial impact on the competitive environment in the local telecommunications sector. The consumer will particularly benefit from this change.

Furthermore, the amendment provides for important safety measures for entities participating in the auction – the ČTÚ will be obliged, prior to announcing a tender, to discuss any conditions of participation, criteria for the evaluation of applications and conditions of the tender with the involved entities. This regulation ensures that important aspects of the tender will be subject to public supervision, which should be a guarantee of a transparent and due tender.

Amendment protects consumer...

Currently, the prices for mobile communication are very high in comparison to the rest of Europe. Recent research by the Parliamentary subcommittee on Electronic Communication and ICT revealed that mobile phone rates in the Czech Republic are over 50% more expensive than those in the United Kingdom. According to the lawmakers and experts, the amendment should bring along a future reduction of prices for mobile phone calls and internet by up to 50%.

The amendment should, among others, improve the position of customers by making contracts for electronic communications services more transparent. For example, providers of connections will be obliged to contractually guarantee a minimal offered and minimal guaranteed quality of service provided to the customer. Practically, this will mean that the operator will, for example, have to make the customer aware of the fact that the quality of the service provided might temporarily deteriorate due to any technical failures or restrictions. The contract will also have to contain arrangements on compensation for damage and reimbursement of money. Such arrangements will be applied in cases of a failure to comply with the quality of service as stipulated in the contract or in case of any disruptions in providing the service or connection.

In addition, the law protects the consumer by imposing a duty upon entrepreneurs to inform the customer of any changes to the contract at least one month prior to the effective date of such change. The customer must be informed of such a change at the operator's expense and in a manner allowing remote access. In some cases, the law gives the customer the option to terminate the contract without any penalties as at the effective date of the change, provided that the customer does not accept the new conditions.

In the event that the operator and the customer enter into a contract for a definite period of time, this period may not exceed 24 months if it is the first conclusion of a contract for the provision of the respective service. At the same time however, the operator must allow the customer to enter into a contract for a period of one year at the most. If, however, the customer explicitly requires so, the contract with the operator may be entered into for a longer period according to the parties' needs.

Any contractual arrangement containing such conditions and procedures regarding the termination of the contract which would discourage the customer from changing the provider of electronic communications services, are invalid by the operation of law.

The ČTÚ will be authorised to impose sanctions on operators in case of any potential violation of the consumer protection rules. For example, a sanction may be imposed upon a company having a significant force in the relevant market for charging inappropriately high prices.

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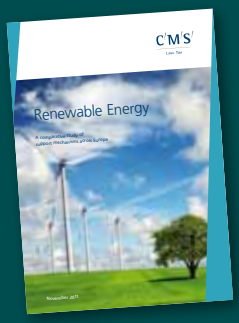

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