OVERVIEW

On January 1, 2014, the new Civil Code (the “NCC”) came into effect, transforming the Czech rules on private law relationships and significantly changing the law on real estate transactions. The NCC unifies previously scattered legal rules within a single code and, at the same time, brings a set of new principles into the Czech jurisdiction. It has important consequences for local and international investors in the real estate market, including acquisitions, leases and development and construction projects.

The NCC (Act no. 89/2012 Coll.) is joined by complementary statutes, including the new Business Corporations Act (Act no. 90/2012 Coll., the “BCA”), which also came into force on January 1, 2014. ¹

The NCC draws on a striking range of sources, including precepts from other jurisdictions and ancient Roman property law, to formulate rules for the Czech jurisdiction. While it is too early to venture an in-depth analysis of the statute, this publication aims to point out some of the major innovations it brings for real estate market investors. These include:

- The long-awaited unification of building and land title
- The expansion of the definition of real property, which is no longer limited to material objects. Instead, the new law enables the transfer of ownership to various rights.
- A new real property right - the right to build
- New rules on the sale of real estate and claims for defects
- Greater protection for good-faith buyers who rely on the Real Estate Register
- Changes to the title registration process
- New concepts of easements, leases and condominiums

Arguably the greatest benefit of the NCC is its increased flexibility. Earlier formalistic approaches tended to invalidate imperfect contractual provisions. The NCC, however, takes an approach to contractual interpretation which presumes a contract’s validity. Crucially, the parties have freedom to regulate their own relationships and may agree on different rights and duties than those statutorily prescribed, unless the law states otherwise.

In general, legal relationships established before the NCC took effect remain subject to the previous law, unless the parties choose to be governed by the new regime. An exception exists for leases, which are bound by NCC rules from January 1, 2014 date even if the lease contract was concluded earlier on.

THE BUILDING IS PART OF THE LAND

The most critical change in the new regulation is its reinstatement of a building as part of the land plot on which it stands. After a long hiatus, Czech law returns to the ancient Roman law principle superficies solo cedit (the surface yields to the land), which held that all buildings located on a land plot and firmly affixed to the ground were an inseparable part of that land.

This principle still holds sway across almost all of Europe. In the Czech lands, it was valid until 1950, when it was abolished. From that time, Czech law stipulated that the owner of a building could be a different person to the owner of the land beneath it. The old law, which applied until December 31, 2013, explicitly stated that a building was not part of the underlying land plot, but a separate unit of real property. Therefore, acquisitions always required a double transfer, involving the conveyance of the building itself and of individual land plots.

In contrast, the new NCC rules mean that the title to a building can now be conveyed simply by transferring the land plot concerned. Some exceptions to the rule persist after January 1, 2014; they include underground buildings with an independent purpose and utility supply networks, including buildings and operationally connected equipment.

While making changes, the NCC respects the situation created by the previous law, whose effect is that many building owners in the Czech Republic do not own the land their building stands on. Building owners who did not own that land on the date when the NCC took effect, can rest assured that their building has not become part of the land or the property of the land owner.

If a building and the plot of land beneath it had the same owner on the effective date of the NCC, then from that date, the building and the land plot became a single unit of real property. If the building and land plot owners were different persons at that time, however, then the building remains subject to the previous law and though firmly affixed to the ground, it is treated as a separate piece of real property.

¹ The BCA promises investors and companies a more flexible regulatory framework, with special benefits for private limited companies and joint-stock companies. Key reforms include the end of a ban on the chaining of private limited companies and a new concept of group structures. Another important new law is Act no. 256/2013 Coll., on the Real Estate (Cadastral) Register.
To accelerate the unification of the ownership of land plots and the buildings situated on them, the NCC grants pre-emptive purchase rights to persons who own either a plot of land or a building but do not own the attached building/land. Land owners have a pre-emptive right to acquire the buildings built on their land and building owners have the same right to purchase the plot where their building stands.

**THE RIGHT TO BUILD**

The NCC also imports a new real property right - the right to build (known elsewhere as rights of superficie; bail à construction or Erbbaurecht). More typical in jurisdictions like Germany, Austria and Switzerland, this right applies in situations where a person wishes to build on a plot of land that is owned by someone else.

The right to build entitles a builder to erect a structure on land belonging to another person. A building constructed based on the right to build, does not become part of the land, and nor is it considered a separate unit of property. This means that the building may not be separately transferred, sold, donated or pledged. Instead it is understood as a physical extension of the right to build. The right to build itself survives the destruction of the building. Under the NCC, that right may be sold, donated, pledged, leased or burdened by a servitude.

Always temporary in nature, the right to build may be granted for a maximum of 99 years, however the grant agreement can always be extended. It may be conferred for consideration or even without any consideration; in either case, it is recorded in the Real Estate Register. While the right is active, the builder has the same rights to the building as the land owner, and it has a duty to maintain the building in good condition. The builder’s duty to insure the building can also be negotiated. In some cases, the right can be conferred over an existing building.

After the right to build expires, the building will automatically become part of the underlying land and the property of the land owner. That owner must provide the builder with compensation equal to half the building’s value at the time when the right to build expired, unless the parties agree otherwise.

**TRANSFERRING OWNERSHIP TO REAL PROPERTY**

The NCC brings important changes to the rules on transferring title to real property. In general, the process of acquiring ownership depends on whether the real estate is listed in the Real Estate Register. If the property is un-registered, then ownership rights transfer on the effective date of the purchase agreement. If, on the other hand, we are dealing with listed real estate, title passes to the new owner from the moment when the transfer is recorded in the Register.

Among the key developments of the NCC, it expands the definition of real property, which is no longer limited to material objects. Instead, the new law enables the transfer of ownership to various rights, such as rights to build or to establish a servitude.

Unlike the law it replaces, the NCC also contains special provisions on the sale of real property, including dealing with property defects. A transfer of real estate specifically includes not just ownership rights, but all defects in the real property that are listed in the Real Estate Register (if the real estate is registered). Other defects are also transferred if (i) the buyer should or could have discovered them given the circumstances; (ii) the parties reached an agreement on their transfer; and/or (iii) their transfer is required by law as in the case of a lease.

In terms of bringing claims, the NCC gives a buyer five years from the time it acquires a building to inform the seller about the discovery of any hidden defects. Should it fail to do this, the court will not enforce a remedy if the seller objects that the defect was not reported in time.

**PROTECTING GOOD-FAITH BUYERS**

Several principles in the NCC create a new concept of the Real Estate Register (also known as the Cadastral or Land Register) as a public register. They include the presumed reliability of the Real Estate Register and rules around “material publicity” and priority rights.

According to these principles, if a right to real property is listed in the Real Estate Register in a person’s favour, then it is presumed to exist. Similarly, if a right is deleted from the Real Estate Register, it is assumed to be extinct. No one may claim that they were not aware of the rights in rem (rights effective against the whole world) that are recorded in the Real Estate Register since anyone can access and check data there by consulting the public records and associated deeds and obtaining their extracts or certified copies.

In this way, the NCC departs substantially from earlier rules, which prioritised the true legal situation in cases when the Real Estate Register records did not reflect this reality. These rules failed to protect persons acting in good faith on entries in the register.
In contrast, the NCC’s material publicity principle aims specifically to protect good-faith buyers who assume an entry in the Real Estate Register is accurate and complete. If the recorded status does not reflect the actual legal status, this buyer may still acquire ownership from the listed owner. The most important land evidence standard in Central Europe, this principle trumps the rule that no one can transfer rights beyond the ones they actually own.

In its most extreme application, the material publicity principle allows for title to be acquired from a person wrongly registered as the real property owner. At the same time, however, the buyer must meet multiple purchasing conditions: the acquisition must happen (i) in good faith, (ii) for valuable consideration, (iii) from a person listed in the Real Estate Register as the owner and (iv) on condition that the true owner does not dispute the entry in the Real Estate Register through formal remedy measures set out in the NCC. These remedial actions include filing a court action to revoke the wrong registration and seeking the inclusion of an official note of discrepancy or dispute in the relevant Real Estate Register entry.

As well as addressing the interests of good-faith buyers, the NCC, thus, offers recourse to real property owners whose rights are impinged by the disparity between the registered listing and the true status. This includes persons whose names do not appear in the register. The new law gives real property owners the option to defend themselves against any loss or rights limitation caused by the application of the material publicity principle. Recourse is especially available for wrong entries caused by invalid or fabricated purchase agreements.

NEW REAL ESTATE REGISTER ACT

The new Real Estate Register Act also came into force on January 1, 2014. Among the changes it brings are new rules on registering real property ownership and other rights. The law maintains earlier forms of registration: insertion, recording and notes. At the same time, the NCC establishes new criteria for determining which data falls in the three categories.²

Under the new Real Estate Register Act, applications to register a right in the Real Estate Register must include a document that serves as the basis for the proposed entry (for example, a purchase agreement, an agreement on the creation of servitudes or other easements, an agreement on the creation of a pledge, etc). One copy of the document should be submitted irrespective of the number of participants in the proceedings. After the entry is registered, the Cadastral Office will confirm this fact to all participants. They will, however, no longer receive a document evidencing registration or a confirmation clause. These procedural changes should be properly reflected in the contractual documents. In particular, payment of the purchase price must not be conditional on the presentation of the purchase agreement along with confirmation from the Cadastral Office. If a party is being represented by a proxy in the registration process, the registration application must also contain a power of attorney bearing the principal’s officially authenticated signature. This is a stricter requirement under the current law.

NEW CONCEPT OF EASEMENTS

The NCC also lays down rules for creating easements. For this purpose, easements are divided into two types: servitudes (negative easements) and real covenants. Servitudes correspond to the earlier concept of easements; they are based on the passivity of the encumbered person. Under the new rules, servitudes require the owner of the encumbered property to allow an intervention or to refrain from acting in some way. As a rule, servitudes may not impose a duty on the encumbered party to actively take any steps. The NCC sets out general rules for all servitudes and special rules for certain servitude types. Special rules apply, for example, to servitudes for engineering networks (utility lines) and for paths and roads.

Real covenants, on the other hand, impose an obligation on the encumbered person to take action, i.e. either to perform some act or to provide some item (e.g. to pay an annuity). A typical example is the duty to provide care of another person (in Czech “výměnek”), which can be imposed on the owner of an encumbered plot of land. This

² Rights registered by insertion under the old law are treated identically in the new system. In addition, this category now incorporates the right to build, negative pledge rights, lease-related rights and new usufructuary rights (a usufruct is a right of enjoyment enabling its holder to derive profit or benefit from property that is titled to another person, so long as that property is not damaged or destroyed). All of these rights are registered by insertion regardless of whether they arise under agreements or by direct operation of law or court decisions. In contrast, rights attached to ownership rights are registered by recording; these include especially rights to use real property, such as the right to use state or municipality-owned property that is entrusted to a city district. Registered notes contain significant information required by law about the listed real property. Examples are information about the reservation of priority rank, priority rights to establish further ownership, rights to exclude affixed equipment from the real estate, or about trust succession and buildings that are not part of the land plot.
owner must take care of the entitled person by providing not only shelter, but also financial support and relevant personal services.

A significant change in the regulation allows owners of multiple land plots to encumber one plot for the benefit of another one on their property. This was not permitted under the old system, which required an easement’s entitled and encumbered persons to be two different entities. The new rules state that encumbered objects may include not only land, but other legally recognised items, such as moveable property, if their nature so allows. A servitude may be created over these items; a real covenant may be imposed on any amenable object listed in the public register.

LEASING BUSINESS PREMISES

Major changes have also been unveiled in the realm of leases. Act no. 116/1990 Coll., on the Lease and Sub-lease of Non-residential Premises is abolished, and the term “non-residential premises” is no longer used in the new rules. Instead, the NCC includes general provisions on leases along with separate provisions on the lease of residential flats and houses, business premises, moveable property, transport vehicles and accommodation including timesharing.

All leases are governed by NCC from January 1, 2014, even if the lease agreement was concluded beforehand. The previous law applies solely to issues about the lease’s validity and rights and duties arising before the effective date of the NCC.

When assessing whether older lease agreements are covered by the NCC provisions on business premises leases, the purpose of the lease is decisive. These provisions apply if the lease is meant to allow business to be performed at the premises and the premises are used at least predominantly for that business activities. This approach is correct regardless of whether the lease’s purpose is explicitly stated in the lease agreement. This means that most pre-2014 lease agreements of this kind will become NCC agreements on the lease of business premises. Where the NCC provisions on the lease of business premises do not apply, the general lease provisions in the new code prevail.

The NCC offers the parties many options from which they can tailor their mutual rights and duties in order to regulate a lease of business premises in the standard way. If they do not agree on modifications, the NCC default positions apply. The new law explicitly permits the lease of premises which are to be created in the future so long as those premises can be sufficiently defined in the lease agreement. Until recently this was an area of doubt among legal theorists and practitioners. The NCC dispels these doubts and allows a lease agreement to be concluded even before a use permit is issued for the premises concerned. The statute also condones the transfer of an entire lease agreement if the parties agree on that prospect.

It is recommended that the parties devise and agree on their own terms for lease termination conditions and rental payments. The lessor especially may find the application of general NCC provisions disadvantageous. Sec. 2287 of the NCC, for instance, gives the lessee the right to terminate the lease within a definite period if there is a change in the original circumstances which would make it unreasonable for the lessee to maintain the lease relationship.

The NCC also imposes a higher level of responsibility on the lessor, particularly for the acts of third parties. For example, the lessor must inform the lessee about any third party which claims to own or have other rights over the leased object or which requests that object’s release or vacation; in these circumstances, the lessor must also provide protection to the lessee if the lessee so requests. If the lessor fails to give the lessee sufficient protection, the lessee may terminate the lease without any termination period. Furthermore, if the lessee’s use of the object is disturbed or if it is otherwise bothered by the actions of third parties, it has the right to a reasonable reduction of the rent as long as the lessor is notified of these facts in due time.

In general, a change of the leased object’s owner will not affect the duration of the lease agreement under the NCC. This principle has some exceptions, however. If the new owner had no reasonable cause to doubt it was purchasing an unleased object, then it may terminate the lease within three months of learning about the lease’s existence and the identity of the lessee under Section 2222 (2) of the NCC. The NCC also states that if the lessor transfers ownership rights to a leased object, the new owner will not be bound by the lessor’s non-statutory duties (i.e. duties not prescribed in the NCC), unless it knew about them. There is a real risk of misuse of the rights in this area.

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Registration of a lease in the Real Estate Register always requires the approval of the lessor while the lessee’s consent is not essential. A lease may, thus, be recorded in the register by the owner itself or by the lessee with the owner’s approval.

In a wholly new development under the code, compensation is now available to lessees for the takeover of their
customer base. The entitlement arises if the lessor terminates the lease, and the lessee has created a customer base there for the lessor or for new lessees. This right may not be enforced if the lease was terminated due to a gross breach of the lessee’s duties. The customer base must have been created by the lessee itself, and not for example by the previous lessee or by the lessor itself in the period preceding the lease.

The NCC also introduces a right to object to the termination of a lease. The concerned party must make any such objections in writing within one month of the date when the termination notice is delivered. If the leased premises are vacated as per the termination notice, then the notice will be deemed to be accepted without objections. Similarly, if objections are not made in the allocated time, the concerned party cannot contest the termination in court proceedings.

With the lessor’s prior consent, the lessee may transfer the lease as part of a transfer of the business conducted at the premises. For this purpose, however, both the lease transfer agreement and the lessor’s consent must be given in writing.

CONDOMINIUMS

The regulation of condominiums is another area which sees substantial changes. The NCC defines both residential and non-residential units as real property comprising part of a building that is a spatially separate plus a share of interconnected and inseparable common areas. Special provisions are set out on the transfer of a unit. This transfer no longer requires the specification of terms (e.g. identification and description of the flat, definition of common areas, identification of land plot, etc.) that were once mandatory so long as the transfer agreement remains sufficiently clear. The new law imposes further duties on owners, particularly vis-à-vis other unit owners and the person responsible for building management.

The duties are balanced by the award of more rights to unit owners, who are expressly allowed to freely manage, exclusively use and reconstruct the interior of their own flat, and to use the common areas of the property. At the same time, these persons must not prevent other unit owners from exercising these same rights, and they may not endanger, change or damage the common areas. On becoming a unit owner, a person must inform the other unit owners in the building about its ownership. The communication should happen through the person responsible for building management and include the address and number of people living in the unit. The new owner must

fulfil this duty within one month of the date when its ownership became or could have been known (i.e. usually the transfer registration date in the Real Estate Register). The same rule applies where there is any change to its registered data. If an owner breaches its legal obligations in a manner substantially limiting or blocking the rights of unit owners and it does not respond to a court order to take remedial action, the court may decide on the sale of the unit.

The NCC takes effect at the same time as Government Decree no. 366/2013 Coll. on the regulation of issues connected with flat co-ownership, as amended. This decree includes changes to rules about the calculation of a flat’s floor area.

SUMMARY

The NCC introduces a series of very significant changes to Czech law. The emphasis in the law on contractual freedom will probably cause many parties to regulate their own rights and duties directly in their agreements rather than relying on the statute. At the same time, they will need to exclude default NCC regulations which could dramatically affect the legal and economic positions of the contractual parties. This will entail the drafting of specific contractual provisions. At first sight, therefore, the new law can be expected to have a slightly negative impact, increasing the degree of legal insecurity. In the long-term, however, and once certain issues and some drafting errors in the new legislation are clarified, the NCC is likely to have a positive bearing on the Czech real estate market.

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