



Group Interest in the Czech Republic

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Abstract. The author is interested in the provision of group interest in the new law for groups of companies in the Czech Republic. She describes the differences between influence, control, and concern, and defines the conditions of the prioritization of group interest before a company interest. At the end of the article, the author focuses on the key questions of the consequences of prioritization of group interest and (non-)binding instruction.

Keywords: group of companies, group interest, instructions in a group of companies

Groups of companies are a day-to-day reality, not the intended results of the development of corporation law during the last two hundred years. For the building of a European internal market, the existence of groups of companies is essential. The foundation of subsidiary companies is a typical expression of the secondary freedom of business.¹ A group of companies is an economic unit without legal capacity. According to the economic point of view, the companies within the group are interdependent and are created as one unit with a common interest. On the other hand, according to the legal point of view, an individual company in a group is independent of others with its own interest. Thus, for groups of companies, there are typical conflicts of interests.² The subject of conflict is whether in law there is not only loyalty to the company but also loyalty to the group of companies of which the company is a member. In the first part, my paper is focused on how a conflict of interests in a group of companies is solved by the new Czech law. In the second part, I shall respond to key questions regarding group interest.

1 Doležil 2008. 45.

2 Doležil 2008. 164.

The Development of the Czech Law

In Czech law, we have had express provisions regarding the law for groups of companies from 1st January 2001. The provisions were in the Commercial Code (Act no 513/1991 Coll.). The basic regulation was in sec. 66a to 66c of the Commercial Code. The regulation of contractual concern was in sec. 190a to 190c of the Commercial Code. This regulation was under a strong influence from German law so that groups of companies could be divided into factual and contractual concerns, and the Czech law used the same legal instruments as German law.^{3,4} We had some Czech specification, e.g. a report on relationships between group companies was available for everyone through the Commercial Register.

The old law was presented by the Civil Code from 1964 (Act no 40/1964 Coll.) and the Commercial Code was submitted by a new law: the new Civil Code (Act no 89/2012 Coll.) and the Business Corporation Act (Act no 90/2012 Coll.).⁵ The law for a group of companies is regulated mainly by the Business Corporation Act and, in particular, in sec. 71 to 91. The main question is how much the law is changed by recodification. Is there still a strong influence from German law? Or has German law been replaced by French doctrine? We can say that the Czech legislature's intention was a combination of the advantages of both of these systems and the elimination of disadvantages. The question is whether this was successful or not. The new recodification of the law for groups of companies does not recognize the contractual concern. The law for groups of companies does not provide for the controlling contract, which was recognized before recodification in the Commercial Code as a contract type with prescribed requirements, procedure for conclusion, and consequences for conclusion and breach on which all risks of business of the subsidiary is ultimately borne by the parent company.

Basic Principles

Firstly, it is important to make this statement. The Czech legislature considered that express provision of group of companies' regulation is better than no express provision. The main reasons are: legal certainty, lower transfer costs, and the legitimacy of interventions by the parent company;⁶ the discussion about the question on whether interventions are allowed or not is resolved; exactly this question is reduced by the conditions of interventions.

3 Černá 2004b.

4 Černá, Pelikánová 2006.

5 The English versions of both acts are available at: <http://obcanskyzakonik.justice.cz/index.php/home/zakony-a-stanoviska/preklady/english>. The German versions of both acts are available at: <http://obcanskyzakonik.justice.cz/index.php/home/zakony-a-stanoviska/preklady/deutsch>.

6 Doležil 2008. 164.

As we have corporate governance as a system of governance for a company, we can say that we have rules of governance for a group of companies. The law for a group of companies has three functions: protection of the group, protection of creditors, and protection of minorities. As in corporate governance, a main standard for the protection of the company is the interest of the company, just as in the governance for a group of companies a main standard for the protection of a group of companies is a concern privilege, specifically the concern interest. The main task of legislation for a group of companies is the specification of the conditions for the prioritization for the group of companies. The privilege of concern is only part of the law for groups of companies in addition to the protection of minorities and protection of creditors. The basis of privilege of concern is the idea that the concerns are a reality with advantages for all of the community, e.g. stakeholders, providing the concerns are transparent. If the law defines a concern as an economic unit with a single management, this situation is not possible without the performance of influence and it is better for all to specify the conditions for influence allowed rather than to forbid the performance of influence and all real existing concerns are outside the law. The conditions shall be given in law so they can be fulfilled practically and not only theoretically. The conditions are tested for the permitted single management and non-permitted single management. The conditions shall be adequate for the protection of creditors and minorities but also adequate for the functionality of a group of companies.

For the protection of creditors and minorities, Czech law for a group of companies contains specific instruments (see below).

Czech law for a group of companies does not distinguish between joint-stock companies and limited liability companies. And that is not all. In short, Czech law for a group of companies shall be applied to each form of business corporations, i.e. for unlimited partnership, limited partnership, and cooperative. I consider that case of unlimited partnership the common provision of corporate law regarding this form of business is enough for the protection of company members and creditors, and further rules regarding the law for groups of companies are not convenient.⁷

Czech law does not distinguish between wholly-owned companies and others. The single difference is the fact that a wholly-owned company does not have minorities and the protection for minorities is not applicable.

For understanding it is important to underline that in Czech law it is generally not permitted to instruct the management of a capital company in day-to-day business.⁸ There are two exceptions: requested instruction and instruction in concern.

⁷ Doležil 2008. 169.

⁸ Čech, Černá 2009. 11.

Influence, Control, and Concern

The legislature has changed the structure of the regulation. Up to 31st December 2013, there had been two important categories of interaction for groups of companies, whether there was a relationship to control or there was a concern. An influence at a general level was not considered.⁹ The influence was outside the standing instrument but now it is the basis of regulation. At present, an influence is the core of the regulation with special provisions for control and concern. Some authors speak about three levels of regulation for groups of companies.¹⁰

What are the main differences between influence, control, and concern? Influence is common for all, but there is a different quality. An influence is legally relevant outside a group of companies, only if it is substantial and has a detrimental intention. We call this: simple influence. This simple influence can be individual outside a group of companies or permanent in or outside groups of companies. In this case, it is not permitted to prioritize another interest other than its own company interest. The consequences for performance of negative influence for an influential person are a liability for damages to the company and to the members of the company and a position as legal guarantor to creditors.

If there is a relationship of control, we can talk about a group of companies, but not about a concern. A relationship of control is given if another person exercises control or has the possibility to exercise control but does not exercise it. Control can be individual or permanent. The same regulation is applied for control as for influence (non-permission of prioritization of another interest, liability for damages to the company and the members of company and a position as legal guarantor to creditors), and further extra obligations such as the duty to make a report of relationships between companies in a group and the sell-out by minorities. In fact, the impact of control can be narrower than the impact of influence. This could be if influence is not exercised in a relationship of control.

Finally, concern is the highest level for a group of companies. This concern is only for a group of companies which is an economic unit under a single management. Single management means that there is the existence of a common concern interest, a single policy and conceptual management and coordination. As we say, this single management is not conceivable without the exercise of influence. Another obligation is connected with concern, the duty to publish the existence of concern on the websites of each member of the group. Concern is the only case when another interest can be prioritized before the interest of

9 Černá, Pelikánová 2006.

10 Černá 2015.

the company. However, the main question is whether the interest of the group is different from the interest of the company. In other words, just as we have a *business judgment rule* in general for the directors, we have *concern privilege rule* for them in a group of companies. The sense of both rules is the same: 'a safe haven' for directors. At first sight, it may seem that there are large differences between a company interest and a group interest, and one must be privileged over the other. However, in fact, the subject of the difference between them is that one is a short-term interest and the other is a long-term interest. So, perhaps the basic question is not checking each instruction in a group of companies but checking fair distribution of roles within a group of companies. The consequences of concern are the same as the consequences of control in the case of extra obligations, i.e. the duty to make a report on the relationships between companies in a group and the sell-out by minorities. The main difference between influence and control on the one side and concern on the other side is that there is a duty to settle harm in a concern, but not for damages. This is a subject of concern privilege, but only on the condition that the company is not insolvent. The company's bankruptcy eliminates concern privilege, and all relationships between the company and the others in a group are assessed under a regime of influence.

When we compare the consequences, we can see that with the existence of a group of companies, the scope of consequences grows, but if the group of companies is a concern, this scope diminishes. The widest range of duties is in the case of control with the exercise of influence.

Prioritization of Group Interest

What are the terms of prioritization of group interest? We can recognize four conditions.¹¹

The first term is the existence of concern as an economic unit under a single management.¹²

The second condition is the declaration of concern. The act requires its publication on the website, but there is the question if this is the best arrangement. Therefore, the website could be multilevel, and it can be difficult to prove if the declaration is on there for all of the time of the membership of the concern. The details of the declaration are under discussion. In our opinion, it would be better to register this fact in the Commercial Register and, of course, in cases of dispute, it would be significant whether the membership of concern is publicly known or not. The condition of publication on the website is a basic but formal condition. This condition is new and it *de facto* replaces a controlling contract. The declaration of concern is a formal

11 Doležil 2008. 114.

12 Černá 2014a. 34.

confirmation of the existence of the concern, by all its members, and of the fact that they are its members.

The third condition is the presumption of settlement of harm. What can we consider under this term? The management of a subsidiary can prioritize the group interest if it does not have any doubt about the settlement of harm, if needs be. Let us give some examples. This condition would not be given if the parent company were not able to settle a harm which may occur. Or another example: in the past, the parent company has not settled any harm and there is no relevant sign of a change to this bad practice. In short, we can say that this condition is fulfilled when it is more advantageous in a long-term perspective for the company to be a member of the concern rather than make a short-term disadvantageous decision.¹³

The fourth and last condition is that the prioritization of group interest is not detrimental to the company and would lead to the bankruptcy of the subsidiary.

Now we can summarize what the prioritization of group interest is. The parent company can instruct the subsidiary in day-to-day business. There is no liability for damage but only an obligation to make a settlement of harm. Finally, the parent company is not a guarantor to creditors. This concern privilege is not valid if the subsidiary is in bankruptcy. Then the parent company is only in a position to influence and control itself with all its duties and liabilities.

What is a group interest which can be prioritized? The Business Act does not use the term 'group interest'. Unfortunately, the words of the relevant phrases in sec. 72 par. 1 Business Corporation Act are '...in the interests of the dominant [directing – note by author] entity or another entity with whom it constitutes a concern...' and in sec. 81 par. 1 Business Corporation Act are '...in the interests of the dominant [directing – note by author] entity or other person with whom the dominant person forms a concern'. The Act does not speak about a group of interest, only about the interest of the parent company or the interest of the other company, which is a member of the concern. We must interpret this wording of the law according to its sense. The doctrine concludes that the prioritized interest is not an interest of another particular member of the concern but of the concern as an economic unit. It is not a simple sum of the interests of the group of companies.¹⁴

In some circumstances, the interest group may be an interest of the parent company or it may not. It depends on whether the interest of the parent company in a particular situation is the same as the group interest. It is also possible that the interest of the parent company and the group interest may be in conflict. For example, the saving of a subsidiary before bankruptcy may be against the interest of the parent company but in the interest of the group, e.g. the protection of its reputation.

13 Eichlerová 2009. 78–79.

14 Černá 2014a. 35.

Another important problem under discussion is the difference between a liability for damage and an obligation to make a settlement of harm. The basis of this question is about the business risk to the concern. Does the subsidiary share the risk of the whole group of companies or not? If we have a single management, we cannot distinguish single instructions from the parent company. And the following question is: if the subsidiary is in bankruptcy, should the parent company be liable for this failure?

In the Czech Republic, the interpretation of settlement is discussed in detail. The subject of this discussion is about the nature of intra-group solidarity in a concern. All discussion corresponds with the interpretation of sec. 72 par. 1 and 2, which adds ‘...the damage ... *was or will be settled* within the concern’ (par. 1) and ‘[t]he damage referred to in paragraph 1 *is or will be settled* if it was or will be compensated within a reasonable period of time and within the concern, with adequate consideration or other demonstrable benefits arising from the membership in the concern’.

We can recognize two basic interpretations: broad and narrow.

Those who follow a narrow interpretation state that settlement is only possible if each harm is quantified in monetary terms and is settled by advantage quantified by the same sum of money.¹⁵ This interpretation does not mean substantial changes between the old and the new law. There is only an advantage of time and the manner of settlement. In fact, this interpretation means a combination of German factual and contractual concern. This allows instructions in day-to-day business; so, there is an element of contractual concern. Also it is given liability for single harms, not for all losses as an element of factual concern.

The broad interpretation states that the long-term balance of advantages and disadvantages of membership of the concern is important for the settlement and quantification is not necessary.¹⁶

I would like to point out two difficulties. One is the annual base for assessment and the other is the independent tax law. Let us think of the advantages of the concern to the subsidiary. Better access to loans is typical. In addition, better contractual terms sometimes result in the parent company being a guarantor for these loans. If we can quantify this service, we have a problem under tax law because the financial authorities may begin to think that this advantage should be the object of taxation.

Are the instructions binding or not? As I said before, the giving instructions in concern (group) context is exemption from a general prohibition of instruction in the day-to-day business of capital companies. If we can find the right response to this question, it is necessary to ask what the consequences are if the instructions are not followed by the management of the subsidiary? And who is bound to

15 Černá 2015. 227.

16 Pelikán 2012. 137.

follow instructions and to whom are they bound to? Is there a relationship between the directing company and the management of the subsidiary? Or is it the liability of the subsidiary for not following instructions by its management? And is it a breach of duty of care by the management? In our opinion, there is no relationship between the parent company and the management of the subsidiary. Not following instructions is legally irrelevant. The instructions are not binding, it is only 'a safe haven' for directors for the prioritization of the group interest before the company's interest.^{17,18}

Conclusions

The group interest is an interest of the group as an economic unit, i.e. the interest of long-term prosperity and economic stability. A strong group of companies produces advantages for its members and that is the reason why the group interest is in accordance with the company interest. Only in case that a subsidiary is a 'Cinderella' within a group of companies: the company only carries a cost and receives no benefits; if the roles in a group of companies are not distributed fairly, then it is not in the company's interest to act in behalf of the group's interest, and concern privilege cannot be applied.

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17 Havel 2015. 126.

18 Černá 2014a. 37.

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