GROUP INSTRUCTIONS REGARDING BUSINESS MANAGEMENT: THE CZECH AND EUROPEAN PERSPECTIVES

Stanislava Černá,* Petr Tomášek**

Abstract: *The paper aims to address the group instructions regarding the business management of a controlled company. At the beginning, the essence and function of business groups is outlined. Subsequently, the authors deal with the term of business management which, not only in the Czech law, has no statutory definition. It is stated that two basic approaches to instructions relating to business management can be distinguished – "group friendly" and "group reluctant". Following general description of both, the authors deal with conditions for giving group instructions in the Czech Republic, of which jurisdiction is widely considered to be "group friendly". Jurisdiction of other European countries (the Slovak Republic, Germany, France, the Great Britain) is being discussed afterwards. The finals parts of the article deal with the cross-border instructions within the international groups of companies, as well as with the harmonisation effort in the area of group instructions regarding business management of a company.*

Keywords: *business group, controlled company, group instruction, interests of the group, business management, instructions regarding business management, business judgement rule, service subsidiary, ordinary subsidiary*

1. ESSENCE AND FUNCTION OF A BUSINESS GROUP

Business groups play an important role in the economic life of European and non-European countries. Generally, this term refers to groups of business corporations that are interconnected in such a way that the person standing at their top has a real opportunity to exercise a decisive and significant influence on the conduct of business corporations located at the lower levels of this hierarchically interconnected structure. Typically, the building blocks of a business group are the ownership interests of the controlling entity in the controlled corporations. Within the EU, the formation of business groups, by establishing subsidiaries or by acquiring shares in existing companies, manifests the freedom of establishment under Articles 54 and 55 of the Treaty on the Functioning of the European Union.

An indisputable advantage of a business group is the **economic independence** of its members. This enables the controlling entity to carry out business projects through a designated controlled company without other members of the group having to bear the financial consequences in case of failure. They are only liable for their own debts and not for the debts of another subsidiary in the group. Only in exceptional cases have the courts of some states pierced the "corporate veil" and imposed liability on the controlling entity for the debts of the controlled company.[1] Therefore, an economically healthy and func-

* Professor, JUDr. Stanislava Černá, CSc., Faculty of Law, Charles University, Prague, Czech Republic
** JUDr. Petr Tomášek, Ph.D., Faculty of Law, Charles University, Prague, Czech Republic

[1] For more information, see for example: KŮHN. Z. Fikce samostatnosti právnických osob a její prolomení. *Právní rozhledy*. 2003, No. 11, p. 544, ČERNÁ, S. Is it possible to break the barrier separating the property of a business company from the property of its owners? In: *Czech law between europeanization and globalization: New phenomena in law at the beginning of 21st century*. 1st ed. Praha: Karolinum, 2010, pp. 280–292.

tioning business group (*going concern*) requires a limitation of the business risk to the individual members.[2]

Furthermore, the grouping of business corporations is **reflected in their corporate governance**. It allows for uniform planning and determination of the basic objectives of a business group as one economic unit, while internally delegating the implementation of particular tasks to the elected bodies of individual controlled business corporations. The possibility of **tax optimization** of the consolidated group also plays an important role. However, the last decade has seen efforts to fight against its abuse at the European level.[3]

However, the positive effects of business grouping which appear in the area of private law, in particular the possibility to promote one "business will" in the market environment, are counterbalanced by the competition aspects. A group of companies able to act in a coordinated manner on a particular market may **potentially distort competition**. It is in the public interest to provide protection against this risk, and accordingly any sanctions are to be imposed by public authorities (the Czech Office for the Protection of Competition at the national level or the Commission at the European level).[4] In the eyes of competition law and according to the specific circumstances, a business group is treated as a single competitor.

This paper explores the private-law effects of the grouping of business corporations. We focus primarily on the ability of the person at the top of a group to give instructions regarding business management to controlled companies.

2. BUSINESS MANAGEMENT

The instructions of a controlling entity **predominantly** concern **business management**. The term business management has no statutory definition under Czech law. However, it has been widely discussed in case law. In general terms, case law construes business management as *"decisions concerning the business activities of a commercial company"*,[5] or to be more specific, corporate management involving in particular *"the organization and management of its business activities, including business plan decisions"*.[6] A similar defi-

[2] Lately, this advantage of business groups has been somewhat weakened, in particular when one or more commercial companies within a multinational group (integrated in terms of their economy and interests) go into liquidation. In such cases, the insolvency law of corporate groups tends to go beyond the economic independence of individual companies. For more information, see also KRÁLIK, D. Koncern v medzinárodnom práve súkromnom. In: K. Eichlerová et al. (eds.) *Rekodifikace obchodního práva – pět let poté. Svazek I. Pocta Stanislavě Černé*. Praha: Wolters Kluwer ČR, 2019, p. 287.

[3] Compare: Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

[3] Compare: Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

[4] This does not preclude any private claims against the competitor, which could arise from the violation of competition rules (in the Czech Republic Act No. 262/2017 on Competition Damages, on the European level Directive 2014/104/EU of the European Parliament and of the Council).

[5] Resolution of the Supreme Court of 3 June 2009, File. No. 7 Tdo 543/2009; of 20 September 2006, File No. 5 Tdo 956/2006; of 28 August 2008, File No. 5 Tdo 959/2008; of 28 March 2012, File No. 5 Tdo 361/2011-II.

[6] See the Supreme Court judgment of 25 August 2004, File No. 29 Odo 479/2003; the Supreme Court resolution of 5 October 2005, File No. 5 Tdo 1208/2005; the recent judgment of 21 January 2017, File No. 21 Cdo 2525/2015; the judgment of 7 August 2017, File No. 21 Cdo 1355/2017; and the judgment of 22 August 2017, File No. 21 Cdo 1876/2017.

nition can be found even in the administrative justice system which defines business management as *"continuous regular management of the affairs of the company and its business, i.e., deciding on the organization, technical matters, business, personnel, finances, and other day-to-day issues."*[7] This competency concept thus includes, inter alia, the management of the company's employees, determination of their remuneration[8], and also decisions on supplies, sales, or advertising.[9]

However, it would not be appropriate to limit the normative importance of business management to decision-making only. The case law indicates that business management also includes "related" activities such as designing business plans or undertaking economic analyses.[10] Furthermore, business management is involved when dealing with authorities or courts[11], or when establishing and maintaining good relationships with customers, auditors, lawyers, tax advisors, and financial and governmental institutions.[12] These activities are not business decisions, but rather represent a practical, functional aspect of the company's activities. Therefore, the doctrine sometimes calls them *"purely practical measures"* and includes under them, for example, interviews and correspondence.[13]

Under Czech law it is **prohibited to give instructions regarding the business management of capital companies**. Under stock corporation law, specifically s. 435 (3) of Act No. 90/2012 Sb., on Commercial Companies and Cooperatives (Business Corporations Act) (the "BCA"), nobody may give instructions to the board of directors regarding business management. The prohibition to give instructions also applies to an executive of a limited liability company (s. 195 (2) of the BCA). In fact, if a member of a governing body is to be held fully liable for the damage caused to a company in which he or she exercises his elected office, such a person should also be able to decide fully on its business management. This should obviously occur within the limits of the legal regulation, the service contract, or other arrangements. The only exceptions are, in addition to the instructions given within a group of companies (s. 81 (1) of the BCA), the instructions which the member of the governing body in a capital company requests from the supreme body (s. 51 (2) of the BCA).

[7] The judgment of the Supreme Administrative Court of 18 March 2005, File No. 4 Afs 24/2003; and two concurring Supreme Court judgments making a reference to that judgment: the judgment of 7 August 2017, File No. 21 Cdo 1355/2017; and the judgment of 22 August 2017, File No. 21 Cdo 1876/2017.

[8] The Supreme Court judgment of 27 October 2015, File No. sp. zn. 29 Cdo 250/2015.

[9] The Supreme Court resolution of 5 April 2006, File No. 5 Tdo 94/2006; the resolution of 26 August 2009, File No. 5 Tdo 894/2009; the resolution of 25 August 2016, File No. 6 Tdo 738/2016.

[10] The Supreme Court resolution of 23 February 2017, File No. 5 Tdo 1044/2016.

[11] The Supreme Court resolution of 22 June 2012, File No. 29 Cdo 1356/2011.

[12] The Supreme Court judgment of 20 January 2016, File No. 21 Cdo 2831/2015. In the same decision, the Supreme Court found that *"it is not possible to separate advisory services provided to the clients of the company regarding taxes, accounting, corporate and managerial issues, negotiations with new clients about the conclusion of contracts and price quotations, and supervision over day-to-day operations of the company, including office work, from business management and decision-making about the company s matters which are the main responsibilities of the company s executive…"*.

[13] ČERNÁ, S., ČECH, P. Kde jsou hranice obchodního vedení? *Právní forum*. 2008, No. 5, p. 453.

3. DIFFERENT APPROACHES TO THE POSSIBILITY TO GIVE INSTRUCTIONS

For the functioning of business groups, including those with an international dimension, and to enable them to operate in concrete, it is crucial to determine whether **in a particular state the law governing a controlled business corporation allows the controlled business corporation to provide, "at the initiative" of a top group entity, support to another company in the group, although this support (a contribution for the benefit of the whole group) would cause harm to the controlled business corporation** (e.g. to cede an interesting business opportunity, to transfer part of the clientele, to provide business or non-business credit on favourable terms, to provide a financial guarantee or other means of securing debt, to enter into a contract with another controlled company on less favourable terms than would be achieved outside of the group, etc.). In other words, whether a particular legal system allows a subsidiary to accept an instruction from a parent company regarding its business management, even if such an instruction is disadvantageous for the subsidiary as such. In fact, the underlying question is whether it is possible to lawfully put the interests of the group above the interests of a subsidiary. The answer to this question has an impact on how the members of the governing bodies[14] in a controlled business corporation discharge their office. They decide on the business management of the controlled company and therefore they tend to be targeted by the person at the top of the business group. If the law sets out the conditions under which a member of the governing body of a subsidiary or sub-subsidiary may accept a currently disadvantageous instruction from the "headquarters", or if it determines the conditions under which such an instruction is binding, it creates a safe environment for the performance of their duties. At the same time, it effectively allows the group as a whole to operate in concert. However, it should be added that the right to give instructions regarding business management applies exclusively to the governing body and **not to the general meeting** as the supreme body of the company.

Various EU countries have adopted different approaches to instructions regarding business management. With some simplification, there are "**group friendly**" countries (e.g. Czech Republic, France, Germany) that have special legislation or case law enabling the controlling entity to give instructions to a controlled company regarding its business management in the interests of the entire group. At the same time, members of governing bodies of the controlled companies are allowed to accept these instructions without sanctions, even if they are disadvantageous for "their" company. Other countries can be described as "**rather group reluctant**" (e.g. Slovak Republic). They do not expressly allow the "group headquarters" to give a subsidiary such instructions regarding its business management. Yet it would be very simplistic to conclude that they do not provide protection to con-

[14] Under Czech law, the term "governing body" refers to a body which may represent a legal entity in all matters (s. 164 (1) of the Civil Code), and has (from its own perspective) all competence that is not entrusted to another body of the legal entity by its constitution, a statute, or a decision of a public body (s. 163 of the Civil Code). Unlike other jurisdictions (e.g., France) where the governing body is a body whose competence is regulated by the articles of association or other constitutional documents, the Czech governing body has unlimited competence to act, as well as the so-called residual competence. The law specifies governing bodies for specific types of business corporations (s. 44 of the BCA).

trolled companies, their members, the members of their bodies, or the creditors. While such countries do not have comprehensive special regulations regarding groups of companies, the protection mechanisms are based primarily on traditional institutes of liability and damages, or on special insolvency rules. The Czech Republic undoubtedly belongs to the former group. It is a group friendly country. However, this conclusion should be explained in greater detail.

4. CONDITIONS FOR GIVING INSTRUCTIONS REGARDING BUSINESS MANAGEMENT IN THE CZECH REPUBLIC

The recodification of Czech private law, based on Act No. 89/1992 Sb., the Civil Code, Act No. 90/1992 Sb., on Commercial Companies and Cooperatives (Business Corporations Act) and Act No. 91/2012 Sb., Governing Private International Law, has introduced **fundamental changes to the regulation of business groups**. The previous "pre-recodification" rules set out in the repealed Commercial Code (Act No. 513/1991 Sb.) (the "ComC") were mainly influenced by German corporate group law. **Before recodification, Czech law** drew a distinction between a *de facto* group (s. 66a of the ComC) and a contractual group (ss. 190a to 190j of the ComC). The former was defined negatively, i.e., the controlling entity s position was not based on a control agreement. Controlling relationships within the ***de facto* group** usually rested "only" on ownership interests without any specific (nominate) control agreement having been concluded between the controlling entity and a controlled company. In principle, the controlling entity was not allowed to use its influence to enforce the adoption of measures or the conclusion of a contract that could result in property damage for the controlled company. There was an exception if the controlling entity made a payment for the damage within a stipulated time or at least concluded a contract setting the deadline and method of payment (s. 66a (8) of the ComC). If this duty was breached, the controlling entity had to compensate the damage caused by nonpayment. The members of the governing body of the controlling entity were jointly and severally liable for the discharge of this obligation. The members of the controlled entity s governing body were jointly liable with them if they had prepared an incomplete report on relations (s. 66a (15) of the ComC). The liability did not apply in cases where these members of the governing body acted based on an ordinary resolution of the supreme body of the business corporation.

The Czech pre-recodification law granted relatively generous options regarding business management instructions to a dominant entity in a **contractual group**. The basis was a control agreement. According to s. 190b of the ComC, *"Under a control agreement, one contracting party (the dependant entity) undertakes to submit to another person (the dominant entity) for single management"*. The control agreement thus gave the dominant entity the right to give instructions to the governing body of the dependant entity, even if such instructions could be disadvantageous for the dependant entity, as long as they were in the interest of the dominant entity or of another entity within the group. However, the wide ability to interfere in the business management was counterbalanced by the obligation of the dominant entity to compensate the dependant company for any loss established in its financial statements that could not be paid from its reserve fund or other liquid assets, regardless of whether the loss was due to the instructions from the dominant

entity or something else. This regulation also included relatively broad provisions on of the liability of members of governing bodies of both the dominant and dependant companies. Thanks to these robust safeguards, the controlled companies in the contractual group were not obliged to prepare a report on relations. However, the regulation of the contractual groups was not widely used in practice, in particular because such a group arrangement did not entail any tax advantages like those in the German system which had inspired it.

The current Czech regulation of business groups, based on ss. 71 to 89 and other related provisions of the Business Corporations Act, has departed from German corporate group law. It was inspired by the French concept of a group of companies, based in particular on the Rozenblum decision (criminal panel of the Cour de cassation of 4 February 1985).[15] Numerous European experts specialising in corporate group law created at the European level have also endorsed this concept, and consider it as a possible starting point for the future provisions of the European corporate group law. The Czech legislation further developed and modified the French approach. Unlike the French legal system, where corporate law is based on case law and on individual provisions scattered in various regulations, the Czech Republic has **systematic private-law regulation of corporate groups contained in the above-mentioned Business Corporations Act.**

The Czech legislation provides a person at the top of a group with a **legal instrument to legitimately assert its influence on the business management** of subsidiaries, subsubsidiaries, and other controlled companies. Specifically, **it allows such person to give instructions regarding business management to the bodies of controlled companies, as long as such instructions are in the interest of the entire group** (e.g. an instruction to enter into a contract with a specific supplier or customer under specified conditions, an instruction to purchase shares in another business corporation)[16]. However, such an option is available to the controlling entity **only if** the business group is manifestly highly coherent and has the features of a group of companies. A group of companies is a group in which one or more controlled entities are subject to **single management**.[17] This implies that a group of controlled companies is (a) interlinked through a long-term **common interest** which is (b) implemented by a **single policy** developed for the entire group, and (c) within this common policy, **at least one** of the relevant components or tasks is **coordinated and conceptually managed** within the group s business activities. If a business

[15] Bull. Crim. N. 54, JCP 1986 II, 20585.

[16] S. 81 (1): "A body of the dominant entity may give instructions to the bodies of the dependant entity regarding the management of its business, where these are in the interests of the dominant entity or other person with whom the dominant entity forms a group of companies."

[17] S. 79:
"(1) One or more entities subject to single management (the "dependant entity") by other person or persons (the "dominant entity") shall form a group of companies with the dominant entity.
(2) Single management shall mean the influence of the dominant entity on the activities of the dependant entity aimed at coordination and the conceptual management of at least one of the important components or tasks within the group's business activities, in order to ensure the long-term promotion of the group's interests under the group's single policy.
(3) The existence of a group of companies shall be published by its members without undue delay on their websites, otherwise the procedure defined in Section 72 cannot be applied."

group does not have these characteristics and is therefore not interlinked through single management, then the entity at its top cannot give members of the governing bodies of the controlled companies binding instructions regarding their business management. Even if such instructions are given, they are not binding and members of the governing bodies are, without exception, bound by the duty of loyalty towards their own company, i.e., by regard to the company's own interest. A disadvantageous instruction from the controlling entity must therefore be rejected. If the members do comply with the instructions, they are principally liable for the damage incurred by the controlled company. Therefore, if the controlling entity wishes to use the option of giving instructions regarding business management, it must use its controlling position to upgrade the entire business group, subjecting it to single management and thus turning it into a group of companies. The **group** thus represents, in a sense, **qualified control**. The existence of a group of companies can be proved, for example, by the approval of the group's single policy at the general meetings of the individual controlled subsidiaries, by the fact that the members of the elected bodies of the dominant company are members of the elected bodies of controlled companies, and by cash flow coordination (cash pooling), coordination of purchases, sales, and scientific research, common legal services, joint invoicing, and so on.

In addition to these substantive conditions, the right to give binding instructions regarding business management is subject to a formal condition. It is the **publicity** requirement: the members of the group of companies must **publish** the existence of the group on their website (s. 79 (3) of the BCA[18]). This is to ensure that all parties concerned are informed that the business group has the status of a group of companies.

The right of a dominant entity to give instructions is connected with the rule that **the damage caused to a dependant company by the dominant entity s instruction given in the interests of the group as a whole can be compensated in a specific way**: by appropriate consideration or another demonstrable advantage arising from membership in the group (for example, a bank loan granted to a dependant company thanks to a "trustworthy" parent company). It is an **expression of intra-group solidarity**. However, the literature presents a range of views on what can be considered compensation for damage. Czech case law on this issue is not yet available, and foreign case law does not provide many examples either. It follows from the Czech legislation that a member of the governing body of a single-managed subsidiary which has been given instructions (for example, to grant a loan on more favourable terms to another subsidiary, to yield business opportunities to another group member, or to be a guarantor for its debt, etc.) first needs to determine whether such instructions are in the interest of the group. If this interest is not entirely obvious, the member must ask the dominant entity to specify the wider context of the instructions. The member also needs to check whether, as a result of complying with the instructions, the dependant company will sustain damage and whether the damage can be compensated within the group within a rea-

[18] S. 79:
"(3) The existence of a group of companies shall be published by its members without undue delay on their websites, otherwise the procedure defined in Section 72 cannot be applied."

sonable time by an appropriate consideration or another demonstrable advantage. Members of an elected body of a dependant company are therefore not released from the duty of care of a prudent manager, but they may act contrary to the isolated interest of their company according to the set rules. Of course, the instructions must not be fatal for the dependant company. This regulation can be seen as a **business judgement rule for groups of companies**. It should be remembered that the duty of care of a prudent manager that must be exercised by a member of an elected body of a dependant company is manifested in a specific way within the group, both in terms of loyalty and the necessary knowledge and diligence.

5. OTHER APPROACHES TO INSTRUCTIONS REGARDING BUSINESS MANAGEMENT

The **Czech Republic** gives members of the bodies guidance on how to proceed when instructions regarding business management are given. At the same time, the Czech rules make it easier for the dominant entity to single-manage the corporate group. However, this does not happen everywhere in Europe.

The **Slovak Republic** which is, for many reasons, closest to the Czech legal system, is reluctant to allow instructions regarding business management. Although the Slovak legislation, unlike Czech law, lacks an explicit prohibition on giving instructions to the governing body regarding business management in a joint-stock company, it fails to provide the conditions under which it would be possible to do so within a business group. In fact, the Slovak Commercial Code[19] contains few provisions dealing specifically with groups of companies. This is not to say that controlling entities of Slovak joint-stock companies may not tend to influence the business management of controlled companies. On the contrary, the stronger the controlling entities, the more likely such efforts are.[20] However, rather than determining the conditions under which the controlling entity would be allowed to interfere in business management, the Slovak legal regulation focuses solely on the protection of the controlled company. The protection is primarily secured by making the *de facto* members of the governing body liable, or by imposing liability on the controlling entity responsible for the insolvency of the controlled company, if the controlling entity substantially contributed to the insolvency.[21]

The basis of **German corporate group law** is contained in the Stock Corporation Act (AktG[22]) which governs the legal regime of a controlled joint-stock company and a limited partnership after their inclusion in a group. While this regulation is systematic, it is quite complex. It is applied to limited liability companies through case law and to a large extent by analogy. Traditionally, German corporate group law aimed to protect the controlled

[19] Act No. 513/1991 Zb., the Commercial Code, as amended.

[20] ŠTENGLOVÁ, I. Omezení převoditelnosti akcií. In: K. Eichlerová et al. (eds.). *Rekodifikace obchodního práva – pět let poté. Svazek I. Pocta Stanislavě Černé*. Praha: Wolters Kluwer ČR, 2019, p. 265.

[21] Provisions of s. 66 (7) and s. 66a of the Slovak Commercial Code.

[22] AktG (Aktiengesetz) – the Stock Corporation Act of 6 September 1965 as amended (since 1965 the German Stock Corporation Act has contained rules on business groups in s. 15 et seq. and in s. 291 et seq.).

company *ex post*, i.e., after it became a controlled entity.[23] However, it should be added that at present German law also includes *ex ante* protection of joint-stock companies and their minority shareholders, set out in the Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Ubernahmegesetz) resulting from harmonization obligations.[24]

German corporate group law regulates both *de facto* and contractual groups of companies. In practice, however, the contractual groups of companies did not gain a strong foothold, although they had been expected to gradually replace the *de facto* groups. The German concept of a *de facto* group is based on the assumption that even after being incorporated into a business group, members of the elected bodies of the controlled company should make business decisions independently and in the company s own interest. Inclusion in a *de facto* group therefore does not breach their duty of loyalty to their own company. But at the same time the German legal system recognizes the economic reality and, under specified conditions, it allows the parent company to intervene in the conduct of the controlled company. This is subject to the condition that any individual loss arising from the exercise of a controlling influence will be compensated by the end of the accounting period in which it arose. Otherwise, it must be determined at least within that time limit when the loss is to be compensated and what advantages are to be offered. Within the specified time limit, a legal claim to the compensation must be granted (s. 311 of the AktG). Failure to comply with the above duties may lead to financial sanctions affecting the controlling entity and the members of its bodies or, where relevant, the members of the bodies of the controlled company.

France does not have systematic rules on groups of companies. Its case law concerning groups of companies was (as suggested above) an inspiration not only for the Czech Republic but also for other European countries, and has been carefully monitored (albeit sometimes with critical eyes) by the European experts on commercial law dealing with the future partial harmonization of European corporate group law. Interestingly, until quite recently (the 1980s), the autonomy of the controlled company and the inviolability of its own interest were emphasized in France.[25] What was in particular emphasised was wide access to information on the business group. In the following years, however, the French jurisprudence and especially case law recognized the integrity of the group and formulated the conditions under which it is possible to legally subordinate the interest of the controlled company to the interest of the group.[26] It is noteworthy that these issues were not addressed in the context of private-law cases, but in a criminal case, specifically in the case of the misuse of company assets by a dominant entity in the company (*abus de biens sociaux*). The court decision in the criminal case of Marc Rozenblum became the basis of the French approach to influence, i.e., the ability of the dominant entity to legally ensure that the dependant company provides support to another company in the group,

[23] For more details: ČERNÁ, S. *Koncernové právo v Německu, Evropské unii a České republice*. C. H. Beck, Praha 1999.

[24] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004.

[25] GUYON, Y. *Droit des affaires, Vol. 1*. 5th ed. Economica, 1988, p. 595.

[26] Cf.: BOURSIER, M.-E. Le fait justificatif de groupe dans lęabus de biens sociaux: entre efficacité et clandestinité. *Revue des Sociétés*. 2005, No. 2, p. 282 et seq.

although such support is harmful to the dependant company.[27] According to the court, *"…the financial benefit provided by one member company to another according to the instructions of the de jure or de facto directors of a contributing company is dictated by a common economic, social, or financial interest which is considered against the backdrop of the policy defined for the group as a whole. The contribution must not remain without consideration or disturb the balance between the involvement of the various companies in the group, and it must not exceed the financial capacity of the burdened company".* This doctrine is considered by many European experts to be an acceptable model for Europe. They perceive this concept as a foundation upon which the protection of the assets of a controlled company can be built – even in private law.

The **UK** is characterized by a relative brevity of the legislation on the powers of the various bodies of a company. The Companies Act 2006 does not explicitly entrust the decision-making regarding business management to anybody of the company. Therefore, unsurprisingly, there are no rules on instructions within a group of companies. Thus, only the model articles for companies[28] issued by the Secretary of State[29] deal with instructions regarding business management, separately for a public limited company and private limited company. Under s. 20 (2) of the Companies Act 2006, the model articles form part of the company s articles of association in so far as the company s articles do not exclude or modify the relevant model articles. This provision introduces considerable discretion in the default application of model articles.[30] Model articles grant the shareholders the right (by qualified majority) *"to direct the directors to take, or refrain from taking, specified action"*[31], which undoubtedly includes business management. Nevertheless, the power to give instructions regarding business management was granted to shareholders, and not exclusively to the controlling entity. The model articles do not provide any guidance on the possibility to give instructions detrimental to the controlled company. Thus the general legal rules apply, requiring a member of a board of directors to act in a manner that he or she reasonably believes is highly likely to promote the success of the (controlled) company.[32] The success of the controlled company may be identical to the success of the business group. For example,

[27] Bull. Crim. N. 54. JCP 1986 II. This decision was preceded by the decision of the Parisian *Tribunal correctionnel* of 1974 concerning the dominant entities in group Agache-Willot, in connection with the takeover of company Saint Frère.

[28] Model Articles for Private Companies Limited by Shares ("MA Ltd") and Model Articles for Public Companies ("MA Plc"). In: *GOV.UK* [online]. [2020-06-30]. Available at: <https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies>.

[29] The *Secretary of State* refers to a government minister. Specifically, the model articles are issued by the Secretary of State for Business, Innovation and Skills. In *Dignam, A. Lowry, J.* (op. cit.), p. 290.

[30] Likewise, the doctrine infers that *"The distribution of those powers as between the members and the directors is, subject to the provisions of the Companies Act, left entirely to the discretion of those who frame the articles of association."* In WILD, CH., WEINSTEIN, S. *Smith and Keenan's Company Law.* 17th ed. Edinbugrh, UK: Pearson Education, 2016, p. 346.

[31] Article 4 (1) of MA Ltd and MA Plc. Undoubtedly, the articles of association could provide for the right to give instructions based on a simple majority of votes. In HANNIGAN, B. *Company Law.* 4th ed. Oxford, UK: Oxford University Press, 2016, p. 183 et seq.

[32] Cf. s. 172 (1) of the Companies Act 2006: *"A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members…"*

the existence and functioning of the controlled entity depends on the functioning of the group as a whole.[33]

6. PRIVATE-LAW APPROACH TO CROSS-BORDER INSTRUCTIONS

As can be seen from the above examples, in Europe the national corporate legislation and judicial decisions vary when it comes to the conditions under which instructions may be given regarding the business management of controlled companies. At the EU level, there is no uniform corporate group law and the Member States are not striving for its comprehensive harmonization. What has been harmonized are only certain individual aspects around the formation and existence of the groups of companies.[34] Thus the diversity of national jurisdictions is also reflected in the diversity of arrangements between the dominant entity in the business group (typically the parent company) and its subsidiaries. Similarly, there are different conditions for the enforcement of and compliance with the group's instructions regarding the business management of subsidiaries. This situation has a practical impact on the management of international groups of companies. For example, there could be a group in which the dominant French parent company gives instructions to the members of the governing body of Czech, Polish, Hungarian or German subsidiaries or sub-subsidiaries. While these instructions may be in the interest of the group as a whole, they are detrimental to the dependant company. Logically, some members of the governing bodies of subsidiaries would be more willing than others to comply with such instructions, depending on the applicable conditions regarding their office and their potential liability for any damage to "their" company that could result from such compliance.

It is private international law which deals with applicable law regarding a company forming part of a multinational group. This issue, however, is not addressed in a uniform way.[35] We believe that the relationship between a parent and a subsidiary when issuing business management instructions belongs to the domain of company law (*lex societatis*), and the conditions under which a subsidiary or its governing body may comply with the instructions will essentially be prescribed by the legal system applicable to this subsidiary. In other words, these conditions depend on the "personal status" of the controlled company. The Czech jurisprudence of private international law understands personal status in the most general sense as *"legal order, decisive for the assessment of legal issues related to a person, i.e., the legal order governing the formation of a company, its legal nature, legal capacity of the company, including entitlement to act on behalf of a company, its internal relations, partly external relations, transformation, and usually also the dissolution of the*

[33] HANNIGAN, B. *Company Law*, pp. 64 and 65.

[34] For example, Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC; Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, etc.

[35] KRÁLIK, D. Koncern v medzinárodnom práve súkromnom. In: K. Eichlerová et al. (eds.). *Rekodifikace obchodního práva – pět let poté. Svazek II. Pocta Ireně Pelikánové*. Praha: Wolters Kluwer ČR, 2019, p. 287.

company, and possibly some other issues".[36] The relationship between a business corporation and a member of its body (rights and obligations towards the business corporation while the member discharges his/her duties, including compliance with the group instructions) falls under the corporation s organizational structure, and we believe that it can therefore be considered an internal relationship mentioned above. However, the principles for determining personal status (*lex societatis*) have been widely discussed and not yet resolved. There are a number of opinions, ranging from the incorporation principle to the real seat principle; currently there is an apparent convergent trend (and a certain inclination to the former principle).[37] The current Czech law combines both principles.[38] With regard to personal status, the cited author (M. Pauknerová) further notes: *"Naturally, personal status has its limits beyond which other criteria are used: specifically, the status of obligations, tort, or other."*[39] The underlying rules to be applied are those of the Rome I Regulation.[40]

The regulation of the rights and obligations and related responsibilities of members of the governing bodies of a business corporation becomes relevant particularly in the case of insolvency. When the insolvent company has insufficient assets, the creditors, as well as the insolvency practitioner, logically focus on examining the potential financial liability of the members of elected bodies and on enforcing relevant property claims. Under Czech law, the relevant provisions are sections 62, 63 to 67 and 68 of the BCA, or sanctions under insolvency law [s. 98 of Act No. 182/2006 Sb. on Insolvency and the Means of Its Resolution (Insolvency Act), as amended].

When a subsidiary, integrated within a multinational group of companies both in terms of its interests and economy, becomes insolvent, a specific situation arises for the liability of members of governing bodies. If there is an international element, i.e., if the debtor's main interests are located in an EU member state, and at the same time at least one creditor or a part of the assets are located in another EU member state (except Denmark), then the insolvency proceedings and their effects are governed by Regulation 2015/848 (the "Regulation").[41] Under this European secondary legislation, the court of the state within the territory of which the centre of the debtor's main interests (COMI) is situated has jurisdiction to open insolvency proceedings. In accordance with Article 3 (1) of the Regulation, it is the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. If the court finds that it has

[36] PAUKNEROVÁ, M. *Společnosti v mezinárodním právu soukromém*. Praha: Karolinum, 1998, p. 28.

[37] PAUKNEROVÁ, M. Obchodní společnosti v evropském mezinárodním právu soukromém – nové trendy. In: K. Eichlerová et al. (eds.). *Rekodifikace obchodního práva – pět let poté. Svazek II. Pocta Ireně Pelikánové*. Praha: Wolters Kluwer ČR, 2019, p. 102.

[38] Ibid.

[39] PAUKNEROVÁ, M. *Společnosti v mezinárodním právu soukromém*, p. 29.

[40] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). This European regulation determines the law applicable to contractual obligations with an international element in most EU member states. In terms of its content, it draws on the 1980 Rome Convention.

[41] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings.

international jurisdiction under this rule, it will open insolvency proceedings in accordance with its own national insolvency law (*lex fori concursus*).[42]

As regards the liability of members of governing bodies in an insolvent business corporation, it should be noted that the so-called insolvency status applies not only to the procedural rules of insolvency proceedings, but also determines the substantive effects, i.e., the rights and obligations of the persons concerned (the universality principle of insolvency law).[43] It will accordingly govern the liability and any other financial sanctions against members of the governing bodies of the insolvent company.

If the COMI and the registered office of the insolvent business corporation are in the Czech Republic, the Czech insolvency court will apply; in insolvency proceedings with an international element, the Czech insolvency law as a *lex fori concursus*, and at the same time the court will apply the relevant insolvency provisions of the BCA to the members of the governing body of the insolvent business corporation (ss. 62, 63 *et seq* of the BCA).[44] In the proceedings before a general court, it is possible to proceed according to ss. 65 and 68 of the BCA. Thus, any breach during the discharge of duties in connection with insolvency, which may *de facto* also include compliance with the group's instructions, will be determined under Czech law.

The legal situation is more complex if the registered office and the COMI differ. If the registered office is in the Czech Republic, but the COMI is abroad, the applicable law for insolvency proceedings will be the insolvency law of that other state. In the insolvency proceedings, the foreign court will apply neither the Czech insolvency law nor the Czech corporate regulation on the liability (with respect to the insolvency) of a member of the governing body, as it is not part of that state s *lex fori concursus*, but instead will apply its own insolvency law and possibly its own corporate liability provisions. However, the creditors in the Czech Republic will be able to proceed in accordance with s. 68 (2) of the BCA against a member of the body of an insolvent corporation, so that such a member may be subject to two legal proceedings conducted in different legal systems.[45] On the other hand, if the COMI is in the Czech Republic and its registered office is abroad, the Czech insolvency law will apply to the insolvency proceedings, including its provisions on sanctions affecting the members of the governing body (s. 98 of the Insolvency Act). It is not entirely clear to what extent the Czech regulation on the liability of members of elected bodies contained in the BCA (specifically s. 62 of the BCA) can be applied. This question is part of a wider problem: whether or not the corporate law rules are part of the *lex fori concursus*, and if so, which of them.[46] Nonetheless, it is clear that the Czech court will not apply foreign corporate liability rules related to insolvency (e.g., the French Code de commerce,

[42] Exceptions are set out in Articles 8 to 18 of the Regulation.

[43] For more information, see BRODEC, J. Určení COMI v případě přeshraničního insolvenčního řízení a jeho vliv na určení rozhodného práva ohledně odpovědnosti členů statutárních orgánů úpadce. In: K. Eichlerová et al. (eds.). *Rekodifikace obchodního práva – pět let poté. Svazek II. Pocta Iren ě Pelikánové*. Praha: Wolters Kluwer ČR, 2019, p. 81.

[44] Ibid., p. 87.

[45] Ibid., p. 89.

[46] For more details, see BĚLOHLÁVEK, A. Odpovědnost členů statutárních orgánů korporací v případě insolvenčního řízení s mezinárodním prvkem. *Bulletin advokacie*. 2015, No. 7-8, p. 19.

or the German GmBHG or AktG) to the members of elected bodies, as such rules are not part of the Czech insolvency law.

Given the wide diversity of national rules throughout Europe, not only in insolvency law but also in private corporate (group) law, any – even partial – harmonisation of regulation can contribute to the efficient functioning of multinational groups of companies.

7. HARMONISATION EFFORTS CONCERNING SINGLE MANAGEMENT OF A GROUP OF COMPANIES

At the European level, there appears to be a very strong need to harmonize the rules on instructions regarding the business management of controlled business corporations (subsidiaries). The European experts in the *Forum Europaeum on Company Groups* (FECG) are widely discussing this issue and preparing proposals for the partial harmonization of European corporate group law (the idea of comprehensive harmonization has been abandoned at the European level). Furthermore, similar issues are being addressed by the European experts preparing the so-called *European Model Company Act (EMCA*).

So far, the European proposals to address this issue have been rather modest, due to the diversity of opinions and differences in national rules. The expert group submitted the first proposals in 2015,[47] and in 2016. The experts' proposals on the instructions regarding business management in cross-border groups of companies are based on a **distinction between so-called service subsidiaries and ordinary subsidiaries**. A service company is defined functionally, i.e., it performs only ancillary tasks in a group, such as legal support, financial management, central invoicing, etc., as well as by its size (fewer than 250 employees, a balance sheet not exceeding 20 million, or alternatively a yearly turnover of less than 40 million euros). Furthermore, a service company is defined in terms of ownership, as its members must be members of the group. An ordinary company is defined negatively. It is a company that does not meet the above criteria, even though it is also a subsidiary of the group.

It is proposed that the possibility to give instructions should apply to service companies only. However, this general rule for binding instructions should exclude the instructions which prevent a subsidiary from paying its debts to third parties, that are payable within 12 months following the instruction**.** However, if a member of the group (i.e., the parent company or another company within the group), or a third (non-member) person provides the instructed subsidiary with the so-called *revolving* credit (a dynamic

[47] Proposal to Facilitate the Management of Cross-Border company Groups in Europe 2015. *Forum Europaeum Company Groups* – FECG: a group consisting of European academics and practitioners who specialise in corporate group law, founded as a private initiative at the end of 2009 to draw on the work started by the group Forum Europaeum Konzernrecht in the 1990s. The FECG members include: Pierre-Henri Conac (Luxembourg), Jean-Nicolas Druey (St. Gallen), Peter Forstsmoser (Zurich), Mathias Habersack (Mnichov), Soren Friis Hansen (Copenhagen), Peter Hommelhoff (Heidelberg), Susanne Kalss (Vienna), Gerd Krieger (Dűsseldorf), Loes Lennarts (Groningen), Marcus Lutter (Bonn), Christoph Teichmann (Wűrzburg), Axel von Werder (Berlin) a Eddy Wymeersch (Geneva). The proposals of the group were presented for discussion first in Bonn on 14 December 2015 (regarding the service company) and subsequently in Wűrzburg on 11 March 2016 (regarding ordinary companies).

guarantee), the instructions will be binding even then. The guarantor is required prove to the creditor, at his/her request, that he/she is able to honour the guarantee provided. The protection of the members of elected bodies of the instructed subsidiary also includes their right to information about the situation of the group and on the economic situation of the person who provided the dynamic guarantee (effective protection of the service company liquidity). Binding instructions are not to be given to ordinary companies.

To conclude, the **proposal on binding instructions focuses on companies that are expected to have limited relations to third parties**, so that the financial consequences of the instructions do not reach beyond the business group. Nevertheless, if the consequences of the instructions should affect, in a specific way, a third party not involved in the group (see above), then the instruction is binding only if the third party is afforded specific protection. Clearly, the proposal is rather cautious, but it still remains uncertain whether it will be adopted. The instructions jeopardising the existence of a service company are excluded altogether.

CONCLUSION

In order to be able to manage groups of companies effectively, whether national or cross-border, the dominant entity must be able to give instructions regarding the business management of its controlled companies. If the law of a particular state sets out the conditions under which the dominant entity may give such an instruction and a member of an elected body may or must comply with the instruction, it is much easier for the group to operate in concert on globalised markets.

There is no uniform approach to this issue within the EU. Compared with other countries, the Czech Republic belongs among countries with the most group-friendly approaches. Since this approach reflects practical importance of group of companies and eases their functioning, we consider the Czech regulation as successful. This is also manifested in the fact that so-called "big" amendment to the BCA (Act No. 33/2020 Sb.), which becomes effective on January 1, 2021, contains only partial changes and clarifications regarding the group of companies, but retains the basic concept.

At the European level, discussions are underway on proposals for the partial harmonization of European law, suggesting that all European states should allow a dominant entity to give instructions to a service subsidiary, unless the instructions prevent this subsidiary from paying its debts, or as long as the debt is secured by a group member or a third person. The European proposals do not provide for instructions to companies other than service companies.