

Business groups – European development and trends of their legal regulation

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1. THE CHARACTERISTICS OF BUSINESS GROUPS AND THEIR LEGAL REGULATIONS

Business groups are bodies that can be found in all economically developed countries, not only in Europe. They bring their participants significant economic advantages, enable the assertion of economic goals unified with all the members of the group, allow them to focus on certain areas considered to be of key importance from the point of view of the whole, and strengthen the sources enabling the assertion of these unified interests. Moreover they provide an opportunity for the localisation and compensation of losses, as they allow the concentration of unfavourable consequences of business only with some participants of the group. For legal regulation, however, their existence brings quite new problems, because these groups can only with difficulties be described by legal categories that we commonly use when dealing with the subjects of legal relationships.

The groups are usually formed by individual legal entities that, as such, are formally independent and participate in the given whole on the basis of facts that can be classified as facts on which the internal relationships in business organisations are based. It is most frequently gaining shares in other companies or signing contracts on the common exercise of the voting rights. The consequence of these is the violation of the equal position of the subjects, creating the

relationships of dependence and control within the given group and limitations to the autonomy of will of the controlled subjects. This leads to the emergence of structures that as a whole are not legal entities and their individual elements do not lose the character of independent subjects of the law, but at the same time they are linked through relationships that bring inequalities and dependency of the controlled subjects on the controlling ones. Such structure brings tension caused by the conflict of partial interests of the individual participants of the group and at the same time on the necessity to respect the unified interest of the whole group.

The contemporary doctrine of commercial law comes out of the basic signs of the group during the efforts to define it. It emphasises that business groups bring up significant problems in all branches of the law, as the legal regulation is always directed not at one subject, but at a union that may be described as poly-corporate.¹ Business groups are then described as a manifestation of economic concentration, for which it is characteristic to connect in the area of legal regulation the individual legally independent subjects into an economic union following its own business interests, while this whole is not perceived as a legal entity.²

For the given groups, in the legal terminology, especially in Germany, Austria, and the countries influenced by their law, the expression "holding" has become widely accepted where the legal regulation of

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¹ Synoptic report on the activities of the professional committee Forum Europaeum Konzernrecht published in the journal *Zeitschrift für Unternehmens- und Gesellschaftsrecht*, 4/1998, the notion is stated on p. 689.

² ČERNÁ, S.: *Koncernové právo v Německu, Evropské unii a České republice* [Law of groups of companies in Germany, European Union, and the Czech Republic]. C. H. Beck, Praha 1999, p. 4.

business groups is concerned; we speak of the holding law as a part of the law of business companies, and this law concerns the specific legal problems resulting from the existence and activity of these groups.

Legislative theory as well as the theory of the law should deal with the issue of the legal regulation of holdings: whether such structures should be subject to legal regulation at all, how far this regulation should go, and whether it should create a unified system or limit itself only to those individual actions at when instances it becomes necessary.

If the functioning of such a group is based on the control and assertion of a unified interest of the whole group and the autonomy of will of the controlled members of the group is deformed, legal regulation should state the limit of the influence of such control at such instances where inequality could have negative influence on the legal standing of the subjects within or outside the group. Legal regulation of the group thus primarily has a protective function, with regard to the controlled entities, to the members, whose will is not significant for the creation of the group (members that are standing aside), as well as towards third parties standing outside the group, especially the creditors.³

Apart from this, a further area of key importance arises in the questions whether the legal regulation should not also interact with the structure itself and thus provide the necessary level of legal certainty for it.⁴ The group is looked upon as an organisational unit in which the managerial function is performed by the controlling subject who, however, not only takes decisions on the improvement of its share in the controlled entities, but also significantly influences their activity. From the point of view of legal regulation this means that it will be necessary to deal especially with the questions of duties and responsibilities of the controlling entities and the entities that form their managerial and controlling bodies.⁵

2. THE EFFORTS TO HARMONISE THE HOLDING LAW WITHIN THE EUROPEAN COMMUNITIES

Within the European communities, business groups are of significant importance, as they are directly connected with the implementation of the freedom of business. If the way to the concentration of business through improving shares that base the controlling should be open, the connection between the

law of business companies and the legal orders of the individual member states would have to be overcome and a certain minimum level of their mutual harmony in this area would have to be reached.

In parallel to the other directives concerning business societies, the directive on holdings was under preparation since the mid-1970s. Its first preliminary version was presented for discussion to the governments of the member states in 1974 and 1975. On the basis of serious comments, the Committee then re-wrote the proposal and the proposal for the 9th directive originated; its text was finalised during 1984 and presented to the Council to accept. However, because of the insufficient majority, this proposal could not be accepted, and the text therefore does not have the formal requirements of a directive and it was not even published as such.⁶

The proposal expressed views on the grouping of joint stock companies only and was based on the regulation by the German joint stock company law, especially on its division of the holding groups into contractual and actual holdings. It was exactly the close connection to the German law that had caused the denial of the proposal, because e.g. France, Great Britain, Italy, or Spain did not have common principles and accepting the directive for them would actually mean to "import German law".⁷ For this reason, no further work was done on this proposal of a directive and the proposal to this day exists in its preliminary form.

Protective elements to the advantage of the creditors and minor partners of the controlled group also appeared in the proposals for directives on the European joint stock company that originated in the 1970s, but even here, no further use was found for them and they were left out of the text of the directive.

Although legal regulations of capital business companies are nowadays very similar in the member states, significant differences remain in the area of holding law. Two basic approaches have basically established themselves:

- a) German legal regulation, in which one of the basic functions of the holding law is the protective one. It is mainly the entities standing aside the decision process in the controlled companies, i.e. minor partners and creditors of the controlled companies that are viewed as endangered. Their legal position regulated in the common law of business companies does not provide sufficient protection against the uncertain-

³ SCHMIDT, K.: *Gesellschaftsrecht*, 3. Auflage, Carl Heymans Verlag KG, 1997, p. 494.

⁴ The report also points at the protective and organisational function of the regulation of holding structures; report quoted in footnote 1, pp. 677 and 678.

⁵ SCHMIDT, K.: *op. cit.* in note 3, pp. 497 - 498.

⁶ On the development, see LUTTER, M.: *Europäisches Unternehmensrecht*, 4th edition, Zeitschrift für Unternehmens- und Gesellschaftsrecht, Sonderheft 1, Walter de Gruyter, Berlin, New York, 1996, pp. 239 - 240.

⁷ *Ibid.*, p. 240.

ty coming up from the interconnection of the controlling and controlled entity. According to the degree of being endangered, the German law distinguishes among simple control, simple and qualified actual holding, contractual holding, and a holding based on incorporation. The holding law is adjusted within the framework of the joint stock company law, but through the judiciary of the Federal Court of Justice it is transmitted to other forms of business companies as well, especially to the limited liability companies.⁸ A similar regulation exists also in Portugal, the German model was also inspiring for the Slovenian and Czech regulations,

- b) in contrast with this elaborate and relatively very detailed legal regulation, other states proceed differently and use general principles of private law, law of the business companies, and insolvency law to reach factually relevant, effective, and sufficiently flexible regulations that would encompass also the specific features of business groups.⁹ Special rules for the business groups are thus being formed rather by an explanation and application practice.

In this state of development, the holding law came also into the 21st century and it was one of the areas of business companies' law with which the preparatory Committees has not had any success so far. Further development in this area is connected with the reformist efforts of the committee that began in the beginning of the new millennium and continue until now.

The proposals for further development of European law of business companies were to be prepared by the working group "High Level Group of Company Law Experts", established by the Committee in September 2001.¹⁰ In the first phase, this committee was to present a new proposal for a directive on the proposals to overtake, in the second phase it was supposed to deal with the law of business companies as such and to present the essential basis of its further development.¹¹

The result of the work of the committee mentioned is summarised in the Announcement of the Committee to the Council and the European Parliament of May 21st 2003¹², which delineates the basic political goals of the reform and states the plan for work in the individual areas of the law of business companies for three time periods: short-term (2003 – 2005), mid-term (2006 – 2008) and long-term (since 2009).

As far as the holding law is concerned¹³, the conclusions of the expert committee state that the business groups present a legitimate form of business, but that they are connected with many risks for the creditors and stock holders. Legal regulation that should react to these risks will no longer be drafted as a synoptic directive. Therefore the attempts at accepting the 9th directive will not continue, but the individual problems will be solved separately with the help of partial measures. The conclusions also determined three basic areas, into which these measures should aim:

- 1) sufficient extent of publicly accessible information on the structures in which the group is active, relationships within these structures, economic results of the group in a summary,
- 2) determination of the holding's policy – legal regulation should ensure that the management of both controlling and controlled institutions determined the essence of the unified approach of the group, so that it was possible to divide the advantages and disadvantages following from the assertion of group interests among the shareholders of the individual companies in a just way,
- 3) the regulation of holding chains and pyramids – legal regulation should aim at making the relationships within such groups clearer and should not allow for the speculative pyramids created usually by shares in the estate of one mother company in a whole number of other companies ordered into one interconnected chain. Such legal regulation should, at the same time, not hinder business people in their choice of an adequate form of organisation for their activity.

For further approach in the harmonisation of the legal regulations of the member states in the area of holding law, the conclusion of the Committee is important especially with regard to the decline from the efforts to provide a comprehensive regulation of the holdings in one single directive and that it will further proceed by partial steps, by which the clauses important for business groups will be incorporated into the directives whose subject matter lies in other issues. It thus cannot be said that the Committee has given up on the harmonisation efforts in the area of holding law. It is only the process of assertion of these regulations which should reach a certain standard in the individual member states that is changing.

The above-stated procedure does not present anything new for the point of view of holding law harmo-

⁸ See *op. cit.* in footnote 1, p.678.

⁹ *Ibid.*, p. 680.

¹⁰ After its head Jaap Winter, it is also called "Winter committee".

¹¹ BALDAMUS, E.-A.: Reform der Kapitalrichtlinie, Carl Heymanns Verlag KG, Köln–Berlin–Bonn–München, 2002, pp. 44 – 45.

¹² KOM(2003) 284.

¹³ See the Announcement of the Committee, chapter 3.3.

nisation. Apart from the proposal for Directive 9, the partial questions connected to holding structures have been regulated since the 1980s also in other directives. At present, we could state especially the following:

- Directive 7 on the consolidated balance sheet report is of crucial importance here¹⁴ – on the basis of this directive, member states have to oblige the companies belonging to the business group with presenting a balance sheet report, in which all the property and financial matters within the group and the profit of the companies belonging to the group will become apparent. This report must be accessible also to the partners and creditors of the companies of the group. The obligation is binding both for the holdings based on the majority voting status of the participating entities as well as for the ones based on contracts. It should also include the cases when a minority of votes suffices for controlling, and also the groups of equal-status companies standing on the same level. At present, it is becoming apparent from the conclusions of the group of experts for the area of holding law (Forum Europaeum Konzernrecht) that for the time being, no further proposal of a new directive shall be created, as the entire system shall, on the level of the Community as well as in the individual states, undergo significant changes,¹⁵
- Directive 2 on the protective measures prescribed to the advantage of the partners and third parties for the foundation of joint stock companies, the preservation and changes of their stock capital¹⁶ – this directive was amended with Article 24a in 1992¹⁷, which regulates the basic standards for those cases when a certain business company subscribes for shares, gains or owns the shares of a joint stock company. The regulation is based on the fact that these shares are considered to be proper shares belonging to the property of the company. Member states are asked to define the cases in which it will be taken for granted that the joint stock company may exercise controlling influence on another business company or that the joint stock company has the votes at disposal only as a mediator, or may exercise its controlling influence. Further, the member states should state precisely the circumstances under which it will be taken for granted that the joint stock company has at its disposal voting rights of another company. Voting rights connected with the shares in question are to be suspended in such cases.
- Directive No. 2001/34/EC of May 28th 2001 (Official Journal L 217 of August 11th 2001) on the admission of securities to official Stock Exchange listing and information to be published on those securities – this is a regulation of announcement obligation, which allows those who are interested in participatory securities traded on the regulated markets to look at the structure of the owners of these securities in the individual companies. This information may also be used for finding out about the participants of the business groups and of their influence on the individual participants of the group: The announcement obligation was a general institute that encompassed all the physical persons and legal entities that have gained more than 10 per cent of the subscribed basic capital of the business company and was adjusted already in the proposal for Directive 9 as an institute that enables us to learn more about the structure of the partners of a business group. In the contemporary directive, this is an obligation only for the companies whose shares in securities are traded on regulated markets. The reach of the announcement obligation is thus narrower and serves especially for the protection of the capital market investment. Nevertheless, it cannot be said that it did not serve also to the better protection of the partners and creditors grouped in holdings,¹⁸
- Directive No. 94/45/EC of September 22nd 1994 (Official Journal L 254 of September 30th 1994) on company councils – although the directive is matter-of-factly directed at the information protection of the employees, it is based on the reality of business entities' grouping and it sets the standards and the employees' information protection procedures especially for the cases of business groups that are crossing the borders of the member states. If the economic activities of the interconnected companies should evolve harmoniously, the groups active in different states must inform on their business decisions

¹⁴ 83/349/EEC published in the Official Journal L 193 on July 18th 1983.

¹⁵ See report cited in footnote 1), p. 703.

¹⁶ 77/91/EEC published in the Official Journal L 26 on January 31st 1977.

¹⁷ The change of Directive 92/101/EEC of November 23rd 1992, published in the official bulletin Official Journal L 347 on November 28th 1992.

¹⁸ Such announcement obligation is sometimes looked upon as a tool whose functions are different than the protection of the partners and creditors in the holdings. – see ČERNÁ, S.: p. cit. in footnote. 2, p. 61. We think that such an opinion is too polarised and that it is necessary to admit certain holding functions also to the adjustment of the announcement obligation determined only for the companies with shares traded on the regulated markets.

also the representatives of the employees that may be affected by the decisions. For the holding law, it is interesting that defines Article 3 of this directive the notion of a “controlled entity”, which in the sense of the given directive includes any entrepreneur that on the basis of property, financial participation or special agreements may control another entrepreneur. Article 3 contains also the negative definition and states that the quantitative limits of the controlling relationship will be determined by the law of the state to which the given entrepreneur belongs.

- Directive 13 No. 2004/25/EC April 21st 2004 (Official Journal L 142 of April 30th 2004) on takeover bids – this directive is important especially for the creation of business people networking, as it regulates the basic principles of the shares offer with the purpose of gaining controlling influence on another business company. It unites the conditions for the creation of a group and the protection of the partners standing aside. Apart from this, it also anchors the basic principles for the squeeze-out procedures, i.e. for the possibility of forced redemption of shares from minority shareholder, which is used for simplifying the structure of shareholders' company and increasing the efficiency while exercising the rights and obligations of the shareholders in the internal relationships of the society.

Further partial steps may be expected on the basis of the initiatives of a group of experts (Forum Europäum Konzernrecht) and its suggestions. Although they concentrate only on those aspects of holding law that are connected with the law of the companies, their aim is to unify the way business groups are managed, the protection of investors, minority shareholders as well as the creditors of the subsidiaries and thus contribute to better regulation of those areas that have been found to be necessary for the creation of the EU internal market.

3. REFLECTION OF THE EUROPEAN REGULATIONS IN THE CZECH LAW

The elements of holding law have been infiltrating the Commercial Code gradually and over many years. At first, its elements appeared in § 161 of the Commercial Code in connection with the regulation of gaining shares. The third paragraph of the cited clause prohi-

bits the subsidiary of a joint stock company to gain shares of that company.¹⁹

The amendment by the Act No. 142/1996 Sb. defined, among the general regulation of business companies, the notion of a controlling entity, according to which the controlling was bound with a greater amount of voting rights. The clause regulated the increase and decrease in the number of voting rights according to the fact whether the controlling was direct or indirect, and according to who held the shares in question. This regulation, which was mainly of definition character, was followed by further clauses on the legal regulation of joint stock companies: Clause § 161a par. 1 letter b), according to which, when gaining proper shares, the shares of the controlled company owned directly or through, Clause § 190a that rendered the making of agreements on the transfer of profit between the controlling and controlled entity possible, Clause § 183d par. 3 and 4 regulating the announcement obligation, Clause § 196 par. 1 letter d) which enabled personal interconnection between the controlled and controlling entity, and Clause § 196a that stated some softening of the rules preventing the abuse of the company property for the interconnected entities. Although in comparison with the previous regulation, the changes of the Commercial Code text seem to be rather significant, this amendment also presented only some partial steps, which could not have been enough to ensure the effective fulfilment of the protective functions of the holding law neither for minority shareholders, nor for the company's creditors.²⁰

The basis of the current legal regulation, implemented from the Act No. 370/2000 Sb., is again the amended § 66a of the Commercial Code. In its second paragraph, it defines the relation of controlling through the definition of the legal standing of the controlling and controlled entity. The controlling entity is any entity that factually or legally exercises directly or indirectly the decisive influence on the management or operation of a company of a different entity. For easier assessment of the controlling relationship, the law contains the irrefutable presumptions, by which the following entities are always considered controlling ones:

- 1) the entity who is a majority partner in the sense of § 66a par. 1 of the Commercial Code (majority partner is the one having the majority of votes on the basis of participation in the company),
- 2) entity that has majority of the voting rights on the basis of an agreement with another partner/other partners,

¹⁹ For a more detailed commentary on this clause see PELIKÁNOVÁ, I.: Komentář k obchodnímu zákoníku [Commentary on the Commercial Code.] 2nd volume, Linde, Praha 1995, pp. 425 and following.

²⁰ For commentary on the amendment mentioned see PELIKÁNOVÁ, I.: Komentář k obchodnímu zákoníku [Commentary on the Commercial Code], 3rd volume, Linde, Praha 1996, pp. 36 and following and the text of the commentary to the clauses to which it refers on p. 40.

- 3) entity that can assert the election or nomination or dismissal of the majority of people that are not a statutory body or its member, or majority of people that are members of the supervisory board of a legal entity, of which it is a partner,
- 4) entities acting in accord (see § 66b of the Commercial Code), who together have majority of voting rights on a certain entity.

According to the irrefutable presumption in § 66a par. 5 of the Commercial Code, the controlling entity is such an entity that has at least 40 per cent of the voting rights on a certain entity, unless it is proved that another entity does not have the same or higher amount of voting rights.

The second important part of the business group is contained in the Czech Commercial Code, § 66a par. 7, which defines a holding. According to this regulation, a holding originates when one or two entities (managed entities) are subordinated to a common management by another entity (the managing entity). The companies of the managed companies form a holding together with the managing entity. The connection to the controlling relationship is formed by a refutable hypothesis according to which the controlling entity and the controlled entities form a holding, unless the opposite is proved.

The quoted clause regulates also the formation of a holding by stating that the entities can be subordinated to a single management also by a contract. This contract may be signed also between the controlling entity and the controlled ones.

In overview, we can then reach the following alternatives of business groups²¹

- a) a group in which the relationship of controlling and at the same time, a holding is created. If this group is based on the factual controlling relationship, a factual holding originates, if there exists a contract between the controlling entity and the controlled ones, a contract holding originates,
- b) there is no factual controlling relationship between the entities of the group, but their holding relationship is based on a controlling contract. This is a contract holding of two companies with equal rights,
- c) there is a controlling relationship between the entities of the group, but not a holding relationship, because the single management element is missing.

The valid regulation contains, apart from the definition clauses, also all the principles on which the legal

regulation of a holding is constructed, whether it be written regulation as in Germany, or mostly judiciary regulations. With the factual groups, commands of the controlling entity that might be harmful for the controlled entity are not allowed. If the controlling entity has to issue such a command, it is obliged to cover for the harm following the observance of the command. Thus, the controlled entity, whose interests are primary and with whose management the controlling entity must not interfere, is preferred. Whether this command of the law is fulfilled, should be found out by the partners and creditors from the report which the statutory bodies of the controlled entities are obliged to compile and in which they have to state what contracts between the connected entities have been signed in the previous accounting period, what other legal actions were taken to the advantage of these entities, and what other measures were taken to the advantage or on the basis of an impulse of those entities. In the report, it is necessary to specify the payments provided by a controlled entity, possible consideration on the part of the controlling entity, advantages or disadvantages of the steps and measures and methods of compensation for the harm done to another entity, or whether an agreement on the compensation of the harm has been made. This report is filed in the collection of certificates with the registry court and the partners have the same access to it as to the balance sheet report.

As regards the contractual groups, the controlling entity may give commands to the statutory body of the controlled entity, and even such commands that might be disadvantageous for the controlled entity, if these commands serve to the advantage of the controlling entity or another entity with which it forms a holding. The legal regulation here prefers the common interest of the whole group, but to the controlling entity, the obligation to cover for the loss stated in the annual balance sheet report of the controlled entity arises, if the controlled entity cannot cover for this harm from the reserve fund or other sources it has at its disposal. When signing the controlling contract, all the partners of the group must be given the relevant information, the contract is approved by the general meeting of the company and the contract is effective after the announcement that it has been filed in the collection of certificates of the registry court. Minority partners (the law calls them the apart-standing partners) have the right to ask the company to sign a contract on the valued transfer of their shares to the company for a price adequate for the value of the shares.

Although the valid legal regulation respects all the principles mentioned in the text of the proposal of Directive 9 and appear also in the proposals of the group

²¹ In the discussion among the professionals, the classification is stated by Burešová, J. in the article *Závislost ve franchisingovém vztahu z pohledu práva podnikatelských seskupení* [Dependency in the franchising relationship from the point of view of business groups], *Právo a podnikání* 2002, No. 7 – 8, p. 24. However, no single classification criterion has been selected for this classification.

of professionals,²² this did not prevent some problems regarding the explanation. I consider the following to be the most important ones:

- a) is the regulation really applied only in those cases when the people or entities owning the company join, or also in the cases where e.g. one partner holds a majority position in the trading company, but does not own any company and does not even participate in the business of another person/entity,
- b) what facts is the controlling relationship based on – is it only the special fact regulated by the law of business companies, or also any contract, or other legal fact, in which there are only partial elements of controlling,
- c) what will the process be when a factual holding is formed, i.e. the state when the controlling contract has not been signed, but the interconnection of the entities in the group is so intensive and close that it influences all the activities of the controlled entity. The report on interconnected entities loses its sense in this situation, as it is based on the existence of the individual separated and identifiable measures directed from the controlling entity to the controlled one

The solution to these problems must be sought in the explanations to the Czech legal regulation and in the decision taking of the courts of higher instances. Inspiring impulses for the explanation may be found

also in the German regulation, which served as a model for the currently valid Czech law. Partial steps on the basis of the individual EC directives dealing with business companies do not have an immediate impact on Czech holding law. They appear in the relevant special laws (consolidated balance sheet report is regulated in § 22, 23 and 23 and in the Act No. 563/1991 Sb. on bookkeeping; take over bids form a part of the legal regulation of the joint stock companies in the Commercial Code; the announcement obligation is looked upon as one of the protective elements of the capital market and, as such, it is regulated in the Act No. 256/2004 Sb. on business on the capital market – § 122), whose purpose they help to fulfil, while their importance for the business groups is only secondary.

The proposals that have been compiled for further development of the European holding law by the expert group Forum Europeanum Konzernrecht contain a number of very practical thoughts. However, they originated from the comparison of regulations and theoretical conclusions reached in different states and in many ways deviate from the German model, which was to a great extent taken over into the Czech law. Their immediate significance for the explanation and application of the valid Czech regulation will therefore consist rather in the area of principles applied in the holding law. It is, however, not possible to leave it aside while creating a new legal regulation of business groups, which should form a part of the new commercial code currently under preparation.

²² See report cited in footnote 1).