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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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Group Interest in Poland

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Abstract: The purpose of this article is to analyse the legal environment of the conception of group interest in Poland. In the Polish legislation, there is no standard category of the group interest. In the doctrine, we have two competing views of the concept of company interest. The first view is emphasizing the autonomous company interest. From the second viewpoint, company interest is only perceived as 'accessorial' from the perspective of the interests of the participants in the Corporation. This view leads to identifying the company interest with the group interest. The interest of the group of companies was recognized by the Polish courts, whose decision is recognized as the turning-point. The freedom of the parent is significantly limited if the subsidiary includes minority. Such situation requires achieving balance between the interest of the parent and the minority.

Keywords: group interest, company interest, autonomy of parent

The Concept of Group Interest in Poland

1. Legal Norms

The Polish laws regarding the groups of companies have been, by and large, limited to art. 7 k.s.h. (the Commercial Companies Code). The above provision has been accurately defined in the doctrine as *scarce*[1] *or limited*[2] *regulation of the holding law.* It refers mainly to concluding between the parent company and the subsidiary company the so-called holding agreement providing for the management of the subsidiary company or the transfer of profit by the said company, and determines the obligations related to the registration of such

1 Romanowski 2008. 6.
2 Szumański 2001. 20.

agreement.[3] Other provisions of the Commercial Companies Code defining the concept of parent company and subsidiary company, and also other legal effects resulting therefrom, are not to support regulations concerning the operations of the groups of companies as one economic body, but to counteract the negative consequences related mainly to purchasing stocks or own shares and exercising the voting rights. The institution of the capital group is reflected in the provisions of the Accounting Act. In such context, it has specific features and precise duties in compliance with the provisions of the said Act.[4] The concept of fiscal capital group can be found in the provisions of the tax law.[5] Less precise concept of the capital group can be found in the Act on Competition and Consumer Protection.[6]

3 According to Article 7 § 1 k.s.h. (The Commercial Companies Code): 'Where the dominant and the dependent company enter into an agreement which provides for the management of the dependent company or a transfer of profits by such company, excerpts form the agreement with provisions on the liability of the dominant company as a result of non-performance or improrer performance of the agreement and on the liability of the dominant company for obligation of the dependent company towards its creditors shall be filed in the registration file of the dependent company.' Further, Article 7 § 2 k.s.h. states that 'If such is the case, the fact that the agreement does not regulate or that it excludes liability of the dominant company referred to in § 1 shall also be disclosed'. In the light of Article 7 § 2 sentence 2 k.s.h., failure to report the above cited circumstances 'within three weeks of the date of the agreement shall result in the invalidity of the provisions on the limitation or exclusion of liability of the dominant company to the dependent company or its creditors'.

4 The Accounting Act of 29 September 1994 (J. L. No 121, item 591 as amended).

5 Tax capital group is a special kind of tax payer income tax, which operates from 1.1.1996. It can be created only by commercial companies with legal personality (limited liability companies and joint-stock companies), which are established in the Republic of Poland. The creation of such a group is combined with some advantages for companies which created it. First of all, these benefits are applied to simplify the procedure for clearance of the corporate income tax law and the tax advances. If the group consists of the company bringing a loss, it reduces the tax base of the group (based on the Law of 02.15.1992 on the income tax from legal persons, i.e. Journal of Laws of 201, item 851, as amended).

6 The legal definition of the capital group indicated in Article 4 point 14 u.o.k.k. (Act on competition and consumer protection) specifies that capital group is a group of all enterprises which are controlled directly or indirectly by one enterprise, including this enterprise. This broad definition does not indicate binding forms of control between the members of the group. It applies to 'all enterprises', which is widely understood as a group of entities, which include the entrepreneur as defined in the Act on freedom of economic activity, i.e. natural persons, legal persons, and organizational units which are not legal persons, recognized by the law as units with the separate legal capacity – performing business on their own behalf. Act on competition and consumer protection adds to this circle also individuals, legal persons, and organizational units without legal personality but with the separate legal capacity, which organize or provide public services (not business within the meaning of act on freedom of economic activity), natural persons performing proprietorship in their own name and for their own account or engaged in the exercise of such profession, natural persons who have control (within the meaning of Article 4 point 4 uokk) of at least one entrepreneur, even if they do not carry on business within the meaning of freedom of economic activity, if they take further action under the control of concentrations (referred to in Art. Uokk 13), as well as business associations (within the meaning of Art. 4 point 2 uokk) for the purposes of the rules on restrictive practices and practices infringing collective consumer interests.

In Polish legislation, there is no standard category of group interest. The proposal to define the said concept can be found in the draft of the act on amending the Commercial Companies Code of 28 July 2009. It provides for adding to the Code the fourth division entitled: Groups of Companies. Within the meaning of the draft (Art. 4 § 1 p. 5^1), 'the group of companies comprises the parent company and subsidiary company or companies, in actual or contractual permanent organizational solution and with common economic interest (interest of the group of companies)'. In compliance with Art. 21^1§ 1 of the draft, 'the parent company and the subsidiary company, within the group of companies, is governed, apart from the interest of the company by the interest of the group of companies, taking into account justified interest of the creditors and minority shareholders of the subsidiary company'. Moreover, under Art. 21^1 § 2 of the draft, 'the parent company or the subsidiary company should reveal in the register their participation in the group of companies'.[7] According to the draft, the above-mentioned provisions fail to form the principle of priority of the interest of the group of companies over the own interest of the parent company and the own interest of the subsidiary company participating in the group. They rather constitute the directive providing that the role of the parent company or subsidiary company within the group is to try to match the interest of the group of companies with the own interest of a particular company. The said draft of the Codification Commission was widely discussed in the doctrine of law. It was criticized, *inter alia*, for ambiguous regulation regarding taking actions unfavourable for particular subsidiary companies even if, eventually, the profits and losses were justly distributed between the companies within the group.[8]

Company legal interest is a normative legal category (Art. 249 § 1 and Art. 422 § 1 of the Polish Commercial Companies Code). Violation of the company interest authorizes, i.a., members of the Board or the Supervisory Board to appeal the resolution of the shareholders' meeting which is contrary to that interest (Art. 250 and Art. 422 § 2 point k.s.h. – a judicial review of the resolutions of the general meeting of the shareholders). It is the pattern of proper execution of voting rights of the members and the shareholders.

2. Competing Views on the Concept of Company Interest

2.1. The First View – Emphasizing the Autonomous (Subsidiary) Company Interest

Proponents of this view emphasize the need to protect the integrity and the existence of the company as such, thereby strengthening and stabilizing the position of minority shareholders, creditors, and employees. Accentuating the

7 www.bip.ms.gov.pl/Data/Files/_public/bip/kkpc/proj090925.rtf.

8 Domański, Schubel 2011. 8–9.

distinctiveness of the company interest may appoint a counterweight to the aspirations of the majority of the shareholder or sole shareholder to subordinate the subsidiary. It may reduce the risk of taking unilateral actions that favour the majority shareholder to the detriment of the minority as well as lessen the risk of insolvency of the company. On the other hand, this approach hinders the proper management of the group. The primacy of the company interest stems from the law. The priority of the board is the company's interest as an entity separate from the shareholders, and not the interest of shareholders as an indicator of the company's interest.[9]

2.2. The Second View – Company Interest Is Only Perceived as 'Accessorial' – from the Perspective of the Interests of the Participants in the Corporation

The company interest is solely the result of focusing on the complex interests of members and others involved in the activities of the company. This view leads to identifying the (subsidiary) company's interest with the group interest. The primacy of the interests of shareholders facilitates using a set of integrated management instruments and the implementation of a unified strategy by the parent company – leading group. The interest of subsidiaries may be subordinated to the good of the group as a whole, determined by the parent company. However, legitimate aspirations of the minority shareholders and stakeholders should be respected. It increases the autonomy of the parent company and creates the possibility of the subsidiaries' closer subordination to the group.

This approach makes it possible to respect the requirements for the activities of such a group treated – from the business perspective – as a single entity. The parent entity is legitimate to implement a uniform strategy. The board members of the subsidiary are authorized to act in the interest of the parent entity and the group as a whole. Acting in the interest of the group usually falls within the category of acting in the interest of the parent entity. The parent entity is legitimate to implement the uniform strategy of the group leading to maximizing the value of investments in the share rights of subsidiary companies, and at the same time respecting substantiated aspirations of the minority shareholders of those companies. Acting in the interest of the group usually falls within the category of acting in the interest of the parent entity. The interests of creditors, employees, and other stakeholders of companies within the group should be taken into account as individual directive on operation only within clear and precisely defined duties resulting from the provisions of the law, and only 'by accessory', i.e. to take into account the interest of business partners and shareholders. The interests

9 Sołtysiński 2015. 33ff; Szumański 2010. 12ff; Brylowski, Kidyba 2015. 8ff; Olechowski 2010. 673.

of employees, creditors, and other stakeholders rank lower in the hierarchy of goals which should be implemented by the officers of the company. Acting in the interests of the parent entity and shareholders of the entire group is unacceptable when the benefits obtained by shareholders become disproportionate to the negative consequences for the stakeholders (proportionality test). In compliance with the view presented in the doctrine, strict compliance with the ban on acting to the detriment of the subsidiary company and in the interest of the entire group of companies would make satisfying the needs of modern economic turnover impossible.[10]

3. Group with Wholly-Owned Subsidiaries – the Autonomy of the Parent

The above mentioned interpretation of the concept of company interest makes it possible for the parent entity with 100% share rights of the company to make accomplishments, relatively freely, through the scheduled goals – including the strategy of the group led by the parent entity. It is the sole shareholder who defines the interest of the subsidiary company. The capital company can be established for any legally acceptable purpose, which stems from The Polish Commercial Companies Code (Art. 151 §1). Due to the lack of statutory limitations regarding the purposes of establishing companies, the said principle applies also to joint-stock companies. Therefore, it is not impossible to locate loss-generating business activities in a company, indispensable for the correct operation of other companies from the group or the entire group (i.e. 'cost centre'). The parent entity and members of the subsidiary boards – implementing the said strategy – should not be accused of acting against the interest of the sole shareholder subsidiary. It is the parent entity who, as a sole shareholder, defines the interest of the company. The role of the company may be limited to a dependent function in the activities of the group, obtaining as a task the completion of a single activity (sale of products, human resources management, and delivery of raw materials to other companies within the group). The company is, therefore, deprived of independent existence outside the group.

Company autonomy does not exist, in fact, as a good thing in and of itself. The autonomy of the sole shareholder company is necessary, not to protect the company but its creditors, employees, and potentially other groups whose rights may be infringed as a result of excluding the personal liability of the sole shareholder for the liability of subsidiaries (Art. 151 § 4 and Art. 30 § 5 PCCC).

Within the remaining scope, the interest of creditors is protected under a directive ordering the sole shareholder and the management to refrain from

10 Kwaśnicki, Nilsson, 2007. 26.

activities which may put the creditors at excessive and disproportionate risk. Bringing the existence of the company into danger due to the aggressive policy of the group, if it endangers the interest of the creditors, indicates the violation of the provisions of the 'proportionality test', and goes beyond the legitimate conduct in the interest of the company. It is different in the case of taking over the corporate opportunities of a sole-shareholder subsidiary company, which does not affect the ability to fulfil obligations towards the creditors, fails to violate the provisions on the protection of initial capital, and does not lead to disproportionate damages concerning the employees' interest (e.g. group lay-offs not substantiated by the financial standing of the company or the group) but supports the interest of the parent entity or the group. They should be deemed legitimate.

4. Groups with Other Subsidiaries (Multi-Shareholder Company) – the Autonomy of the Parent

The freedom of the parent entity is significantly limited if the subsidiary company includes minority shareholders. Such situation requires a balance between the interest of the parent shareholder and that of the minority. The parent entity cannot demote the controlled company to the role of an instrument for implementing the goals of the group, to the detriment of legitimate aspirations of the minority partners interested in obtaining fair return on investment. The need to balance the interests requires respecting the fundamental interest of business partners to obtain income from the company activity. The parent entity may, within certain limits, decide to choose the long-term growth strategy, which forces the entity to suffer some 'losses' in a short-term perspective. However, it cannot denote the permanent exclusion of the profitability of the company with minority shareholders. The company should adequately benefit from the participation, which will make it possible to compensate for the suffered 'losses'. The benefits obtained by the subsidiary company from the transactions with the parent partner do not need to be of a direct nature. For example, furnishing by the subsidiary company a security on the debt of the parent partner towards a third party may be a prerequisite for ensuring further activity of the holding which ensures the existence of subsidiary company (e.g. it is the sole recipient of its products). Funding may become indispensable for making a particular investment which, in a longer perspective, will bring benefits to all companies within the holding.[11] The decisive factor here should be the general balance for the company resulting from the participation in the holding.

11 Olechowski, 2010. 677ff.

5. Protection of Minority

The protection of a subsidiary's asset intgegrity is achieved by the provision prohibiting any concealed transfers of funds from the company as transactions outside the corporation (Art. 355 § 3 PCCC). This provision is a criterion for assessing the subrogation operations of company assets such as downstream loans, guarantees, which are widely accepted, more problematic upstream loans or cash pooling (Art. 355 § 3 PCCC).

In connection with the transposition of the Thirteenth Directive,[12] protection of minority in a public company has been a little strengthened by the 'sell-out right' in the event of a control take-over of the subsidiary (institution of the mandatory bid from art-s 73–81[13]Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organized Trading, and Public Companies). 'Sell-out right' is also combined with the right of squeeze-out – enabling the minority to require the majority to buy shares following a take-over bid by a shareholder holding not less than 90% of the share capital or by not more than five shareholders holding jointly not less than 95% of the share capital in a closed company (non-public) – Art. 418 PCCC. Other companies (non-public) also have that right.

6. Role of Jurisdiction (and Politics)

The opinion on the 'accessory character' of the concept of company interests relative to the interests of business partners and stakeholders has recently prevailed in jurisprudence. According to the decision of 5.11.2009,[14] the Supreme Court stated that the separate interest of the company as a legal person, disregarding the outcome of the interest of all business partners, determined by common goal specified in the Articles of Association under common goal cannot exist. Therefore, the concept of company interest is a statutory general formula the fulfilment of which requires including compromise-based function of beliefs, aspirations, and conduct.

Along the same lines, the Supreme Court stated in the decision of 22.10.2009[15] that *the interest of the company constitutes a compromise between frequently contradictory interests of minority and majority partners, and its content should take into account legitimate interests of both groups of business partners*. The Supreme Court confirms the traditional interpretation of the concept of company interest as *autonomous interest relative to the interests of particular*

12 Thirteenth Directive 2004/25/EC of the European Parliament and of the Council of April 2004 on take-over bids L 142/12.

13 Journal of Laws 2005 No 184 item. 1539.

14 Case ref. no: I CSK 158/09.

15 Case ref. no: III CZP 63/09.

entities participating in the corporate structure, which results from granting the limited liability company the legal capacity (Art. 11 § 1 and Art. 210 of the Commercial Companies Code). It emphasizes that the *interests of those two categories of entities remain in a functional relationship*. The Constitutional Tribunal in the decision of 2 June 2005[16] emphasized that the interest of the company should not be identified only with the interest of the majority shareholder and that one could not assume that every defensive activity of the minority shareholder would be dictated by the interest of the company or the objective interest of the company.

The interest of the group of companies was recognized by the Court of Appeal in Katowice, whose decision of 3.12.2012[17] is recognized as the turning-point.[18] The Court ruled that the decision – taken in order to implement the common economic goal – of a particular company to formally enter a group associating other companies leads to subordinating 'the activities of the company to the common interest, which indicates, in fact, limiting the independence through strategic decisions dependent on the economic situation in the country and in the world in the interest of the entire group (namely all participating companies)'.[19] First, the Court indicated that the fact of establishing capital companies and the fact that they join corporations fall within the frame of the freedom of business activity, and, moreover, it is a frequently wanted activity because of the implementation of the economic assumptions of the state. In the process, the adjudicating panel defined the concept of the interest of the group of companies as an approved strategy of economic activity of companies which constitutes the 'community of company objectives'. In the said context, the Court found the accusation that the very fact of subordinating strategic decisions of Company X to the interest of Corporation is contradicting the law as being groundless since in a situation like this establishing such relationships, in general, would have to be recognized as unlawful. The Court of Appeal found binding the Company Management Board

16 P 25/02, OTK-A Zb.Urz. 2005, no 6, item 65.

17 Case ref. no: V ACa 702/12.

18 Kwaśnicki, Czekaj, http://www.kwasnicki.com.pl/prawo-holdingowe-interes-grupy-spolek-widza-juz-sady/.

19 The subject judgment was issued based on the following facts: Company X joined the Corporation associating other companies within the same capital group, on the basis of a resolution of the general meeting. The basis of the Corporation functioning was defined in a special Code. Under its provisions, the purpose of each company being part of the Corporation is focusing on the implementation of the Corporate Strategy (i.e. The strategy of the Corporation), while the strategies of individual companies included in its composition are determined by the Corporate Strategy and should be consistent with it. One of the shareholders of Company X challenged the subject resolution accusing it of violating Art. 375, Art. 375[1], and Art. 368 – Code of Commercial Companies. His request was based on the assumption that the resolution of Company X's general meeting had issued its binding recommendation to the Management Board on how to manage the affairs of Company X (through the subordination of its operation to the objectives of the Corporation), and also the Management of Company X was subordinated to the Board of the Corporation.

to the interest of the Corporation acceptable. The said statement results from the assumption providing that since the Corporation too is composed of Company X, subordinating the activities of the Board of Company X to the interest of Corporation constitutes activities in the interest of X Company X as well.

The importance of the said adjudication seems more significant since it is closely related to the controversial Art. 23 para. 2 of the draft of SUP directive (now deleted).[20] It is necessary to mention that the said provision was criticized by the experts of the Bureau of Research Chancellery of the Sejm, who expressed their opinion on the said draft at the request of the Polish Parliament. They found that *the proposal in the draft legal subordination of the board to the sole partner is not necessary to fulfil the objective of the directive and it unduly limits the autonomy of the Board. The Board shall not be bound by orders contradictory to the law or the Articles of Association (Art. 23 para. 2 of the draft); however, it shall be bound by the orders contradictory to the interest of the company and its stakeholders (creditors, employees).*[21]

Another adjudication, which has already cleared the way towards taking into account the interest of the group of companies under the Polish law, is the adjudication on the so-called Szczecin case. In the decision of 2 April 2008,[22] the Regional Court in Szczecin hearing the case, stated, *inter alia*, that 'the specific aspect of holding (…) made it possible to propose the thesis (…) that persons managing the group of companies in particular transactions should be governed by the interest of the entire group and at least (…) such conduct could not be deemed unlawful, certainly upon retaining the minimum autonomy of subsidiary entities and taking into account the interest of partners (shareholders) and creditors of subsidiary companies'. The Court also pointed out rightly that in a situation when there were no precise national regulations the decision-making process regarding the accused might have been affected by the practice of similar economic entities in Europe concerning the commercial operations within the holding. By referring to transactions made between the entities of the holding, the Court emphasized that the nature of liabilities between the parent company and the subsidiary company is not in opposition to the procedure of applying prices between themselves other than market prices, provided that it falls within the interest of the entire holding. The interpretation of the Regional Court was upheld by the Court of Appeal in Szczecin in the decision of 6 May 2009.[23] The Court rejected the accusations of the prosecutor stating that the court

20 Proposal for a directive of the European Parliament and of the council on single-member private limited liability companies (com (2014) 212 final).

21 P. Sobolewski, Opinia w sprawie wniosku dotyczącego dyrektywy Parlamentu Europejskiego i Rady w sprawie jednoosobowych spółek z ograniczoną odpowiedzialnością (COM(2014) 212 final), Warszawa, 28 maja 2014 r. BAS-WAL-WAPEiM-1004/14.

22 Case ref. no III K 288/08.

23 Case ref. no II AKa 142/08.

of first instance made a mistake as to the fact involving unjust assumption of – non-existent in the current state of law – primacy of the protection of legal interest of the group of companies over the legal interest of a single company constituting separate legal entity. The Court has firmly emphasized that the interpretation of the prosecutor supporting the legal and economic autonomy of every company within the holding and, in particular, the statement providing that there was a requirement on the activity of each of the companies (through their representatives) in line with their interests – not necessarily in line with the economic interest of the group of companies the company belongs to – was out of touch with economic reality and prevailing opinions in literature regarding commercial and economic law and economics. Moreover, the Court pointed out that trying to find discrepancies between the interest of the holding and a single entity within the holding, at every transaction made by the accused, was erroneous since it had been indicated that every activity conducted by the accused brought benefits to the entire holding and, consequently, to particular subsidiary companies as well.

7. Conclusions

In summary, serious problems in the Polish company law doctrine were identified as the absence of specific minority rights, which would allow the minority shareholders to obtain compensation in the event of diminution of their investment value in the subsidiary.

Therefore, introducing the concept of interest group to Polish law should facilitate the introduction of new, additional instruments for the protection of minority shareholders and creditors.

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Group Interest in Hungary

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Abstract. In company law, there is a basic principle that the company is an autonomous legal entity and independent from other subjects of law. In the relationship of the parent company and the subsidiaries, we can find two perspectives:
– on the one hand, an economic perspective: the separate corporations constitute one enterprise (the subsidiaries are or can be instructed/directed by the parent company), the group of corporations is a unitary business entity;
– on the other hand, a legal perspective: the coherence and the conflict among the interest of the parent company, the interest of the subsidiaries, and the interest of the group.[1]

Keywords: parent company, subsidiaries, group of corporations, group interest, concern law

I. Fundamental and General Statements in Connection with the Hungarian Group of Corporations

In Hungary, the law of groups of corporations is a special field of company law, but also regulated by the Capital Market Act.[2] The concern: a participant of the economic life acquires influence concerning the mechanism of decision-making in the limited liability company, stock company, grouping and cooperative society registered in the Firm Registry and operated independently; as a result of that, the companies/associations keep their legal independence, but they constitute

1 Conac 2013. 195, 215.
2 CXX of 2001.

an economic unit. Within the law of groups of corporations, we can separate the recognized (qualified) concern and the de facto (actual/real) concern.[3] The recognized concern is based on a contractual relationship, on a control contract. The de facto concern is founded on the fact of influence acquisition, without concluding a contract.[4]

The essence of influence[5] can be:

– a 'voting concern', where a member acquires the determined percentage of votes and exercises his/her voting rights,[6] or

– the right to appoint, to recall, and to establish the remuneration of the executive officers and members of the supervisory board, or

– other way which provides decisive direction and checking for the controlling company above the operation of the controlled company.[7]

There are two points of view in Hungary in connection with the foundation of concern situation:

– a concern situation comes into existence only when the acquisition of share is based on a legal transaction (on privity), but not on a legal fact (for example, inheritance), and not on the oragnizational amendment (for example, merger);[8]

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3 For details, see: Vecsey 2013. 736–745.

4 Papp 2014. 449.

5 Act V of 2013 Section 8:2 Influence:

(1) majority control means a relationship where a natural or legal person (holder of a participating interest) controls over 50% of the voting rights in a legal person, or in which it has a dominant influence.

(2) The holder of a participating interest is deemed to have dominant influence on a legal person if it is a member of or shareholder in that company and:

a) it has the right to appoint and recall the majority of the executive officers or supervisory board members of the legal person; or

b) other members of or shareholder in that legal person are committed under agreement with the holder of a participating interest to vote in concert with the holder of a participating interest, or they exercise their voting rights through the holder of a participating interest, provided that together they control more than half of the votes.

(3) Majority control is also deemed to exist if the entitlements referred to in subsections 1–2 are provided indirectly for the holder of a participating interest.

(4) Indirect control on a legal person means a relationship where a person is able to exercise influence on a legal person that has voting rights in that legal person (intermediary legal person). The scope of indirect control means the percentage of control held by the intermediary legal person, which corresponds to the percentage of control the holder of a participating interest has in the intermediary legal person. If the holder of a participating interest controls more than half of the votes in the intermediary legal person, the control the intermediary legal person has in the legal person shall be taken into account in its entirety as indirect control held by the holder of a participating interest.

(5) The direct and indirect ownership interest and voting rights of close relatives shall be applied contemporaneously.

6 BDT 2002. 173 (Casebook of the Courts).

7 Papp 2014. 449.

8 Vezekényi 2002. 11.

– according to the other opinion, there is no importance of the legal title of the acquisition, the legal grounds can be ipso iure or succesion.[9]

The acquisition of influence is not equivalent to the acquisition of share it can be established by facts of both company law and private law.[10] The fact and the measure of influence adjust to the proportion of votes; it can be reached by a determined percentage of votes or by share with priority voting rights or by establishment of usufruct on the other members' shares or if the other members have shares with priority rights but without voting rights.[11]

The subjects of the concern situation are the controlling/parent company and the controlled companies/subsidiaries. A group of corporations may consist of stock companies, limited liability companies, groupings, and cooperative societies.[12] If a group of corporations is led jointly by several legal persons, they shall enter into an agreement to determine the one enabled to exercise the rights of the dominant member in accordance with the control contract.[13]

The concern law regulates only the acquisition of influence in existing companies, it is irrelevant to the influence originating at the timepoint of the foundation of companies.[14] The regulation of concern law is divided into two parts: the rules of process and legal effect of acquisition of influence (general and dynamic regulation of concern law) and the provisions for special rights and duties connecting with the existing influence (particular regulation of concern law).[15]

The recognized group of corporations means a form of featuring a common business strategy among at least one dominant member that is required to draw up consolidated annual accounts and at least three members controlled by the dominant member under a control contract.[16] By reason of this, the conjunctive conditions in order to establish the recognized group of corporations are the following: at least one controlling member (with commitment to draw up consolidated annual accounts), at least – permanently – three members controlled by the parent company, and these members conclude a control contract (for lack of the control contract, the recognized group of corporations cannot be presumptive)[17] based on a common business strategy. The recognized group of corporations is neither a legal entity nor a legal person,[18] and per se the owner relation cannot justify the existence of concern (holding company).[19]

9 LB Gfv. XX. 31654/200/5; LB Gf. I. 32620/2000/10 (Decisions of the Supreme Court).
10 Papp 2014. 539.
11 Auer, Bakos, Buzás, Farkas, Nótári, Papp T. 2011. 539.
12 Section 3:49 (2) of Act V of 2013 (Hungarian Civil Code; hereafter abbreviated: CC).
13 Section 3:49 (3) of CC.
14 Papp 2014. 540.
15 Papp 2014. 540.
16 Section 3:49 (1) of CC; Miskolczi-Bodnár 2014. 148–150.
17 FÍT 4. Kf. 27.538/2010/5 (Decision of the High Court of Appeal).
18 Papp 2014. 449; FÍT 2. Pf. 21.729/2010/4 (Decision of the High Court of Appeal).
19 Curia Kfv. VI. 37.376/2011/8.

II. The Group Interest

By means of exercising influence, the controlling company can enforce its interests during the operation of the group of corporations. Through it, the interest-identity between the dominant member and the company can be adversely affected, the interest of the controlling member does not necessarily suit the object of the company. One of the duties of concern law is to balance the conflict of interests between the parent company and the subsidiaries,[20] as the exercising of influence concerns the minority of the controlled companies and also their creditors.[21]

This conflict of interests (concern conflict) between the dominant member and the company is legally legitimate, and the 'Treupflicht' is effective only in the de facto concern.[22] The subsidiaries are operating under unified direction (in economic sense) and typically according to the interests of the dominant member.[23] The dominant member subordinates the controlled companies to its business interests in return for adequate compensation of detriments.[24] The interests of the group of corporations are primary until the subsidiaries (and their stakeholders: members and creditors) can proportionally share in the benefits of the concern situation and also in the fair dividing of the disadvantages of the group of corporations.[25] It means that in the recognized group of corporations the dominant member cannot instruct unlimitedly the management of the controlled companies, and the concern situation does not grant exemption from the liability of the controlled companies' directors for detriments caused by the execution of the dominant member's decisions.[26] Tamás Sárközy is of the opinion that:

– the necessary minimum of the autonomy shall be provided for subsidiaries;

– the subsidiaries' management can be instructed only for the reason and to the extent of the performance of the business political conception of the group of corporations.[27]

The recognized group of corporations comes into existence by concluding the control contract (Beherrschungsvertrag, dominating agreement). If only the dominant member holds any share in the controlled member of a group of corporations, no control contract is required; instead, the mandatory layout of the control contract shall be provided for in the instrument of constitution of the dominant member and the controlled member.[28] The control contract lays down

20 Papp 2014. 538.
21 Papp 2014. 540.
22 Darázs 2003. 168.
23 Darázs 2003. 169.
24 Darázs 2003. 182.
25 Gadó 2004. 4.
26 Gadó 2004. 4, Darázs 2003. 175.
27 Sárközy 2003. 31, Gadó 2004. 4.
28 Section 3:54 of CC.

the common business strategy for a group of corporations.[29] The control contract shall, inter alia, contain the following:

– the corporate names and registered offices of the dominant member and the controlled members;

– the mode of cooperation within the group, including the key aspects;

– an indication as to whether the group of corporation is established for a limited period of time or for an indefinite duration.[30]

The autonomy of the controlled companies may be restricted in the manner and to the extent specified in the control contract with a view to achieving the common business objective[31] or the fulfilment of the aim of the group of corporations as a whole.[32] The control contract shall provide for the protection of the rights of the controlled members and for the protection of creditors' interests.[33] The general provisions pertaining to contracts shall also apply to control contract.[34] The control contract restricts the economic independence of the controlled companies and makes possible to realize a unified business conception; the members are acting in the interests of the concern.[35]

In my opinion, the recognition of the group interest can be realized through the content of the control contract and by the determination of the common business strategy. As far as I can see, the common business strategy is not the same as the group interest, the latter being a narrower category: the common business strategy includes the group interest as well, but even more than that (see: business plans, financial reports, budget, business conceptions, organizational relations, etc.). The group's common business strategy is an 'action programme': the establishment and planning of the strategic and market transactions for a long period, the development of the economic and management conception, drafting the business principles and goals, etc.[36] The recognition of the group interest is tangentially expressed in the Hungarian Civil Code in connection with the liability of the subsidiaries' executive officers: the executive officer of a controlled member shall manage the controlled member in accordance with the control contract, under the governance of the dominant member, based on the primacy of the business policy of the group of corporations as a whole; the executive officer shall be exempt from liability to members if his conduct is found to be in compliance with provisions set out in the relevant legislation and in the control contract.[37]

29 Section 3:50 (1) of CC.
30 Section 3:50 (2) of CC.
31 Section 3:50 (3) of CC.
32 FÍT 2. Pf. 21.729/2010/4 (Decision of the High Court of Appeal).
33 Section 3:50 (3) of CC.
34 Section 3:50 (4) of CC.
35 Darázs 2003. 175.
36 ÍH 2005. 34 (Decision of the High Court of Appeal), Vecsey 2013. 734.
37 Section 3:55 (4) of CC.

The management of the dominant member shall have the right to give instructions to the management of the controlled member as specified in the control contract, and to issue binding resolutions relating to the controlled member's operations. If the dominant member's actions are in compliance with the control contract, the provisions of the Civil Code pertaining to the supreme body's exclusive jurisdiction and to management autonomy shall not apply to the controlled member.[38] The executive officers and supervisory board members of the dominant member may also serve at the controlled member as executive officers and supervisory board members.[39] In single-member business associations, the sole member may instruct the management, which the executive officer is required to carry out.[40] These consequently result that the group interest is equal to the interest of the dominant member.

Inside of the group of corporations, there can be a cost-sharing based on an agreement for refunding of expenses – this is familiar at the R&D (Research and Development) firms.[41]

III. Safeguards Contrary to the Parent Company in Concern Law

1. Transparency

The dominant member shall make a public announcement on the formation of the group of corporations within 8 days after gaining knowledge of the last decision on the approval of the control contract on two occasions, at least 30 days apart.[42] The public announcement shall contain the control contract and a notice addressed to the creditors and shareholders of the controlled members.[43] The management of the dominant member shall submit an application to the Court of Registry for the registration of the group of corporations within 60 days after gaining knowledge of the last approval of the control contract;[44] and the firm registry is authentic and public. After the registration, the provisions relating to

38 Section 3:55 (1) of CC.
39 Section 3:55 (3) of CC.
40 Section 3:112 (3) of CC.
41 LB Kfv. I. 35.550/2008/5 (Decision of the Supreme Court), Fővárosi Bíróság 16. K. 31.115/2007/8 (Decision of the Budapest City Court).
42 Section 3:51 (3) of CC.
43 Section 3:51 (4) of CC.
44 Section 3:51 (5) of CC.

members with a qualifying holding shall not apply to the group of corporations and its members.[45]

2. The Buyout Right of the Subsidiaries' Members

The members of a controlled company that participates in a group of corporations may request within a 30-day preclusive period following the second publication of the notice on the formation of the group of corporations that their shares be purchased by the dominant member at the market value prevailing at the time of publication of the announcement.[46] A group of corporations may be registered if all rightful claims of the members of the controlled legal persons have been satisfied or if the court has dismissed the request of the members in a legal action brought to that effect.[47]

3. The Rights of the Subsidiaries' Creditors

If a creditor lays any claim to a controlled member participating in the group of corporations at the time of the first publication of the announcement, the creditor may demand adequate safeguards from the controlled member within a 30-day preclusive period following the second publication of the announcement.[48] Any creditor whose claim is already guaranteed – pursuant to statutory provision or contract – shall not be entitled to demand such safeguards, including if it is not justified in the light of the controlled member's financial standing or of the contents of the control contract.[49]

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45 Section 3:53 of CC, Section 3:324 of CC: Extra commitments of members with a qualifying holding:
(1) Where a member of a limited liability company or a shareholder of a private company limited by shares – directly or indirectly – controls at least 3/4 of the votes, the Court of Registry shall be notified thereof within 15 days from the time of acquisition of such qualifying holding for the purpose of registration and publication.
(2) Within a 60-day preclusive period reckoned from the date of notification of the acquisition of a qualifying holding, any member (shareholder) of the company may request that his shares be purchased by the owner of the qualifying holding. The owner of a qualifying holding must purchase such shares at the market value prevailing at the time when the request was submitted, which value may not be lower than the value the shares represent in the company's own capital.
(3) If the company is dissolved without succession, at the request of the creditors, the owner of the qualifying holding shall cover any claim for which no satisfaction had been provided, provided that the dissolution without succession was brought about in consequence of the poor business decisions of the owner of the qualifying holding. This provision is not applicable in the case where the company is wound up without going into liquidation.

46 Section 3:52 (1) of CC; BH 2006. 91 (Court Order); SZIT-H-Gf-2009-78 (Decision of the High Court of Appeal of Szeged).

47 Section 3:52 (3) of CC.

48 Section 3:52 (2) of CC.

49 Section 3:52 (2) of CC.

A group of corporations may be registered if all rightful claims of the creditors of the controlled legal persons have been satisfied or if the court has dismissed the request of the creditors in a legal action brought to that effect.[50]

Any creditor of the controlled member whose claim reaches 10% of the controlled member's subscribed capital may request the management of the dominant member to provide information on the implementation of the control contract, and on the controlled member's financial standing. If the management of the dominant member fails to comply with the request or if the information supplied is insufficient, the creditor may request the Court of Registry to adjudicate that the dominant member is in breach of the control contract.[51]

4. Protection of the Minority Stakeholders

A group of members controlling at least 5% of the voting rights in the controlled company and the executive officers of the controlled company may request that the supreme body of the dominant member be convened if they notice any substantive or repeated breach of the control contract. If the management of the dominant member fails to comply with such a request within 15 days from the date of receipt, and fails to convene the meeting of the supreme body within 30 days, the Court of Registry shall convene the meeting of the supreme body at the request of the members making the proposal or shall empower the requesting members to convene the meeting within the prescribed deadline. The costs of the meeting shall be advanced by the dominant member; however, if the request is found unsubstantiated, the costs shall be borne by the requesting parties.[52]

5. Employee Participation

If employee participation in the supervisory board is mandatory in at least three controlled members of a registered group of corporations, the supreme body of the dominant member may permit, if so requested by the work councils concerned, that the representatives of employees participate in the supervisory board of the dominant member instead of the supervisory bodies of the controlled members. In that case, the instrument of constitution of the dominant member shall provide for the setting up of a supervisory board if the given member did not have one. The mode of delegation of the representatives of employees in that case shall be regulated by way of an agreement (under the general provisions for contracts) among the management of the dominant member and the work councils of the controlled members affected.[53]

50 Section 3:52 (3) of CC.
51 Section 3:56 (2) of CC.
52 Section 3:57 of CC.
53 Section 3:58 of CC.

6. Regulation of the Relations between the Management of the Dominant Member and the Controlled Member

The management of the dominant member shall have the right to give instructions to the management of the controlled member as specified in the control contract, and to issue binding resolutions relating to the controlled member's operation. If the dominant member's actions are in compliance with the control contract, the provisions of the Civil Code pertaining to the supreme body's exclusive jurisdiction and to management autonomy shall not apply to the controlled member.[54]

If the control contract provides facilities to delegate competence upon the dominant member for the election and recall of the controlled member's executive officers and supervisory board members, and for determining their remuneration, an employee of the dominant member may be appointed as director of the controlled company.[55]

The executive officers and supervisory board members of the dominant member may also serve at the controlled member as executive officers and supervisory board members.[56]

The management of both the dominant member and the controlled member shall report to their supreme body at the intervals fixed in the control contract, but at least once a year on the fulfilment of the objectives set out in the control contract. Any provision of the control contract providing for a less frequent reporting obligation shall be null and void.[57]

7. Measures of the Court of Registry

In the event of any major or repeated breach of the control contract, the Court of Registry shall, upon request by either of the parties with legal interest:

– call on the dominant member to abide by the control contract;
– introduce supervisory measures;
– dissolve the group of corporations.[58]

Besides the safeguards contrary to the controlling company in the concern law, other measures can be found in the Hungarian company law for protection of the subsidiaries – non-exhaustive list:

– the information right of the controlled member;[59]

54 Section 3:55 (1) of CC.
55 Section 3:55 (2) of CC.
56 Section 3:55 (3) of CC.
57 Section 3:56 (1) of CC.
58 Section 3:60 of CC.
59 Section 3:23 of CC: Confidentiality and obligation of information:
(1) The executive officer is required to keep the members of the legal person informed concerning the legal person, and to provide access for them to the legal person's documents, records,

– the prohibition of voting during the passing resolution;[60]

– the liability for the legal person's debts (transfer of liability, Übergang der Haftung);[61]

– the piercing of the corporate veil (Haftungsdurchgriff);[62]

– the wrongful trading,[63] but this provision in the Civil Code does not accord with other relevant rules (§ 118/B in Firm Act and § 33/A in Bankruptcy Act) and with the provision on the liability of the subsidiaries' executive officers (Section 3:55 (4) of Civil Code);

– the safeguards for the lawful operation of the legal person (the judicial oversight of the Court of Registry,[64] the judicial review of the resolution of legal person by court,[65] the protection of minority stakeholders,[66] the arbitration proceeding, [67] etc.).

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and registers. The executive officer shall be entitled to request a written declaration of confidentiality before the provision of information or access.

(2) The executive officer may refuse to give information and to provide access to documents if this would infringe upon the legal person's trade secrets, if the requesting party exercises his right in a manner which is abusive, or if he refuses to make a declaration of confidentiality despite having been asked to do so. If the requesting party considers the refusal of information unjustified, he may request the Court of Registry to order the legal person to provide access to the information.

60 Section 3:19 (2) of CC: Passing resolution:
(2) In the process adopting a resolution the following persons may not vote:
a) any person for whom the resolution contains an exemption from any obligation or responsibility, or for whom any advantage is to be provided by the legal person;
b) any person with whom an agreement is to be concluded according to the resolution;
c) any person against whom legal proceedings are to be initiated according to the resolution;
d) any person whose family member has a vested interest in the decision, who is not a member or founder of the legal person;
e) any person who maintains any relation on the basis of majority control with an organization that has a vested interest in the decision; or
f) any person who himself has a vested interest in the decision.

61 Section 3:2 (2) of CC: Liability for the legal person's debts:
(2) In the event of abuse of limited liability on the part of any member of a legal person, on account of which any outstanding creditors' claims remain unsatisfied at the time of the legal person's dissolution without succession, the member in question shall be subject to unlimited liability for such debts.

62 Section 6:540 of CC: Liability for the acts of members of legal persons:
(2) If a member of a legal person causes damage to a third party in connection with his membership, liability in relation to the injured person lies with the legal person.
(3) Liability of the member and the legal person shall be joint and several if the damage was caused intentionally.

63 Section 3:118 of CC: Liability of executive officers in respect of third parties:
In the event of a business association's dissolution without succession, creditors may bring action for damages up to their claims outstanding against the company's executive officers on the grounds of non-contractual liability, should the executive officer affected fail to take the creditors' interests into account in the event of an imminent threat to the business association's solvency. This provision is not applicable in the case where the company is wound up without going into liquidation.

64 Section 3:34 of CC; §§ 72–91 of Firm Act.

65 Sections 3:35–3:37 of CC.

66 Sections 3:103-3:106 of CC.

67 Section 3:92 of CC.

IV. The Disadvantageous Group's Common Business Strategy and the Types of Liability

If any controlled member of the group is undergoing liquidation, the dominant member shall be held liable for any debt the member may have outstanding; the dominant member shall be relieved of liability if able to verify that the controlled member's insolvency did not arise as a consequence of the group's common business strategy[68] (secondary, unlimited liability).[69] The instruction right of the dominant member and its result, the dependent situation of the controlled member is the reason for the liability of the dominant member.[70] A casual relation must be between the disadvantageous group's common business strategy and the insolvency of the controlled member: the business policy of the group of corporations caused the detriment (reduction of the assets) of the controlled member; the liability of the dominant member following each other is not joint and several.[71]

We have to take into account the disadvantageous common business strategy from the aspect of the controlled member and have to examine the activity of the dominant member.[72]

The continuation of the disadvantageous common business strategy shall be qualified as wilful, intentional, and seriously actionable conduct.[73]

The loan/credit and its partial ceasing by the dominant member to the controlled member, the attempt to sell the share of the dominant member, the single disadvantageous activity of the dominant member, the entering into loss-making contracts by the dominant member, and the infringement of the rules of the accounting act by the dominant member do not base the establishment of the continuation of the disadvantageous common business strategy by the dominant member on the Hungarian jurisdiction.[74] If the origin of the detriments of the controlled member can be traced back to objective economic processes and changes, and therefore the termination of the loss-making subsidiary by the dominant member is a rational owner's decision, then it cannot be considered as the base of the liability of the dominant member.[75] If both the dominant member and the controlled member have losses in consequence of a bad business decision, then it does not mean a disadvantageous common business strategy; the overall

68 Section 3:59 of CC; BH 2007.418; BH 2005. 187 (Court Orders).
69 ÍH 2006. 123; ÍH 2006. 77 (Decisions of the High Court of Appeal).
70 ÍH 2004. 36 (Decision of the High Court of Appeal).
71 2013. P.4 (Decision of the Curia).
72 BH 2008. 91 (Court Order); Török 2009. 181.
73 Török 2009. 181.
74 BH 2008. 91 (Court Order).
75 EBH 2005. 1228 (Decision of the Supreme Court).

effect exercised by particular harms is authoritative for the establishment of the disadvantageous common business strategy.[76]

If the business decisions of the dominant member cause losses to the controlled member, and the advantages and disadvantages of these decisions are balanced within the concern, this conduct of the dominant member establishes the liability of the parent company for the continuation of disadvantageous common business strategy.[77] The disadvantageous common business strategy can be realized by the negligence of the dominant member,[78] by its inactive conduct (no compensation of the subsidiary's loss, no reduction of the capital of the controlled member, no money for the maintenance of the subsidiary's real estates) in that interest of reaching own economic aims.[79] This decision of the Hungarian Curia is a controversial question in Hungarian legal literature:[80] the legal ground of the liability of the dominant member can be a negligence, but only then, when this negligence is an infringement of the rules of law or of the instrument of constitution; otherwise, the Curia gives priority to the creditors' protection against the owner's interest.

We can also find a provision for the responsibility of the controlling company in the act on bankruptcy proceedings and liquidation proceedings, and it is not quite harmonious with the regulation in the Hungarian Civil Code.[81] In respect of the liquidation of a company under control by qualified majority, a single-member company or a sole proprietorship, the controlling party or the sole member (shareholder) shall be responsible without limitation for the company's liabilities which are not covered by the debtor's assets during the liquidation proceedings, if the court has established the unlimited and full liability of such member (shareholder) for the company's debts pursuant to a claim filed by the creditor during the liquidation proceedings or within a 90-day preclusive period following the time of publication in the Cégközlöny (Firm Gazette) of the resolution on the final conclusion of liquidation proceedings, on account of such member (shareholder) having had a permanent disadvantageous business strategy from the standpoint of the debtor company.[82] The content of the statements of facts in Civil Code and in Bankruptcy Act is different:

– the dominant member controls over 75% or 100% of the voting rights in the controlled member on the ground of the Bankruptcy Act;

– the liability of the parent company is valid under liquidation in the Bankruptcy Act and after liquidation in the Civil Code;

76 ÍH 2006. 126 (Decision of the High Court of Appeal).
77 EBH 2004. 1038 (Decision of the Supreme Court); *Winner* (ed.) op. cit. 734.
78 BDT 2012. 2645 (Casebook of the Courts); Nochta 2014. 238.
79 Kúria Gfv. X. 30.082/2012 (Decision of the Curia).
80 Szegedi 2013 26–30.
81 Act XLIX of 1991 Section § 63 (2).
82 Winner (ed.) 2013, 788–789.

– for claims, there is a preclusive period in the Bankruptcy Act, but the general term of limitation is to be found in the Civil Code;

– the condition 'permanent' is required in the Bankruptcy Act, and not in the Civil Code in connection with the continuation of the disadvantageous common business strategy;

– the dominant member is liable for any debt of the controlled member which remained unsatisfied by the subsidiary's assets in accordance with the Civil Code, but as to Bankruptcy Act the controlling company is liable only for such debts which were claimed by the creditors during the liquidation process or within a preclusive deadline;

– the provision of the Civil Code emphasizes the causal relation between the liquidation of the controlled member and the common business strategy.

The act on public firm information, firm registry, and winding-up proceedings also mentions the liability of the dominant member.[83] If the Court of Registry removed a firm with member's limited liability from the firm register by way of involuntary de-registration procedure, the firm's former member – registered at the time of de-registration – shall bear unlimited liability for the outstanding claims of the firm's creditors, if found to have abused his limited liability. A member is considered to have abused his limited liability if having had a permanent disadvantageous business strategy or who disposed of the firm's assets as his own or who supported a resolution, in respect of which he knew, or should have known given reasonable care that such resolution was clearly contrary to the significant interests of the firm. Here there are also differences between the contents of the statements of facts in Civil Code and Firm Act:

– the rule in the Firm Act can be applied only to the member of the limited liability company, for the shareholder and for the member of the cooperative, but not for the member of a grouping (where the member has secondary and unlimited liability); opposite to this, the regulation in the Civil Code refers to all legal entities in concern law;

– the condition 'permanent' is required in the Firm Act, and not in the Civil Code in connection with the continuation of the disadvantageous common business strategy;

– the continuation of the disadvantageous common business strategy is identical with the abuse of a member's limited liability in the Firm Act;

– the liability of the dominant member can be established only after the involuntary de-registration procedure according to the Firm Act;

– the provision of the Civil Code underlines the causal relation between the liquidation of the controlled member and the common business strategy.

83 Act V of 2006 §§ 118/A (1), (2)

After this short overview, I can point out that in Hungary there is no recognition of group interest (neither in regulation nor in the articles of association). From the aspect of group interest, there cannot be found any difference between private and public company or between wholly-owned subsidiaries and others. In Hungarian single-member companies, management must follow the instructions by the parent company, and there are no provisions for the management of controlled members to obey the unlawful instructions of the dominant member. Therefore, I reckon that it is necessary to clarify the concept of group interest, and on its ground the relation among parent company and subsidiaries (for example: according to the instruction right of the controlling company) in Hungary, but also at the EU level, in order to provide a 'safe harbour' for managers of controlling and controlled companies against civil and criminal liability.

V. The Group Interest in Public Companies in Hungary

At the examination of the group interest from a corporate law perspective, the category of publicly owned economic companies (public companies) forms a specific field. Although corporate law, as a universal field, sets the directive to all sectors as background law,[84] and the specific prescriptions of law directive to each different field are included in branch regulations of law, we must still distinguish the public companies. To be more precise, these are specific from several aspects, and thus cannot be regarded merely as one separate branch of economy.

1. The Denotation and Classification of Publicly-Owned Economic Companies (Public Companies)

When we are examining the enterprises and economic companies owned by the state, we must make mention of the privileges of the proprieties as of the municipalities (local self-governments). The Basic Law (formerly: The Constitution) of Hungary declares it in its article on 'The Public Finances' that the proprieties of both the state and the municipalities comprise the national property.[85] The Basic Law, however, declares it separately that the economic organizations owned by the state and the municipalities conduct their economy in the manner determined by acts of law, independently and responsibly, in accordance with the demands imposed by legality, appropriateness, and

84 See: Decision 59/1991 – Constitutional Court of Hungary.
85 Basic Law Article 38. paragraph (1).

productivity.[86] The municipalities hold a privileged position in the Hungarian constitutional settlement,[87] and the same applies to their property as well. Consequently, in the Hungarian legal terminology, when we use the term 'state property' as a synonym to 'public property', in the used (first) term the municipality's property is unentailed. In case we intend to use the term consistently, then we must say in every instance 'the property of the state and of the municipalities' altogether. For the rest of the study, we shall use the term 'public company', by which we shall mean economic companies operating through either state- or a municipality's shareholding.[88]

State proprietorship in general distorts the freedom of economic competition anyway, the consequences of which in economics have been common. Yet, at the same time, the degree of the presence of the state among economic organizations is certainly a matter of public politics' decision-making.[89] In this regard, according to the Hungarian regulations of law in effect, from a civil-law perspective and in terms of the relation between the state and economic companies, we can essentially differentiate between the following three types of state presence. The first case scenario is when the state runs an economic company or is a shareholder in a strategic type of economic company.[90] From this, the next case scenario separates, in which the state presence is needful, whereby it partakes in the economic vitality, which is in other words: the field of public services/utilities. Here, the state presence does not require any proof or justification, unlike the reason why these should operate in the form of economic companies.[91] In our view, these do not necessarily need to operate as economic companies for there are such (typically of public-law) legal-subject categories available, the application of which leads to the achievement of the aimed target. The dissimilar third case scenario category involves companies with peculiar public-law relevance, status such as Hungary's central bank, The Hungarian National Bank (MNB).[92] The Hungarian National Bank is a legal entity, operating in the form of a joint-stock (public) company.[93] In our view, the Hungarian National Property Management plc (MNV Zrt.) falls into the same category as well, which is a one-man joint-stock (public) company founded by the state, and the stock of which

86 Basic Law Article 38. paragraph (5).
87 Basic Law Article 31.
88 On this terminology, see Act No 2009. CXX. 1. § a) point.
89 For instance, the banking sector or the energy industry regarded like that.
90 The Magyar Villamos Művek Zrt. is an example of that, the share of the state in the banking sector.
91 Transport corporations, service provider corporations.
92 Basic Law Article 41, Act No 2013. CXXXIX.
93 Act No 2013. CXXXIX. paragraph 5. §, yet the same Act includes prescriptions different from general civil law regulations, for instance: 'plc' does not need to be indicated in the name of the company and the public company does not need to be registered in the company registry. Act No 2013. CXXXIX. point 5. § (2).

is non-negotiable.[94] The Hungarian National Property Management plc pursues state service, among others, executes proprietary rights over the state fortune.[95]

However, the realization of the general prescriptions of civil law varies with respect to each one of the scenarios, and in fact the specific prescriptions affect relevant elements of the regulation; in the latter case of the MNB and the MNV Zrt., the prescriptions of civil law become restrained, while the specific prescriptions cover the operation exhaustively.

This classification is theoretical, yet this question does have an outstanding value in Hungary. Following the monolithic form of state property before the change of regime in 1989, it was necessary a transformation into business-property of the state in the framework of the public companies.[96] After the privatization in progress at the time of the change of regime, and also in the 1990s, the management of state property developed into its form known today. Thus, the organization for the management of state property has been created: both the Hungarian National Property Management plc (MNV Zrt.) and the municipalities can establish economic companies, certainly with the purpose of completing public assignment.[97] The state property can also be broken down into several constituents, a part of which makes the property of the state in the form of economic shareholding. Here the state can hold either minority or majority proprietorship. Both the management and the administration of this are treated by the MNV Zrt. Regarding its set-up, the MNV Zrt. treats nearly 550 shares, 279 are active companies, 270 are in majority state proprietorship.[98] As regards the municipalities, no such aggregate data are available.

VI. The Directive Rules of Public Companies

As regards the regulation, it can be generally concluded that to these companies also it is the Civil Code, and not the norms regulating the public companies, that are to be applied in general.[99] So, in this case, there is no difference. The specific prescriptions are to be found in the term of property management, included in the Act of Law on National Property, the Act of Law on State Property, and the Act of Law on the Local Self-Governments of Hungary. These acts of law regulate the terms and conditions of founding economic companies in general. Specific prescriptions apply to the organization structure, upon the basis of the directives of the Act of Law as per 2009. CXXII. This regulates the possible size of the board

94 Act No 2007. CVI. point 18. § (1).
95 Act No 2007. CVI. point 17. § (1) c).
96 For more details, see: Sárközy 2012.
97 On this, see: Act No 2011. CLXXXIX. point 41. § (8).
98 www.mnvzrt.hu.
99 For instance, Act No 2006. V. on corporate law regulations or Act No 1991. IL. also including the liquidation procedure rules.

of directors and the board of supervisors, and from a corporate governance angle the framework of the remuneration system has been set. To conclude, we can state that the provision of any public services may be realized in accordance with the general (Civil Code) regulations and the specific prescriptions applicable as a directive only to the organization.

The concern (group) situation disclosed in previous chapters may just as well be realized in various forms: examples are presented regarding contractual[100] concern. To the running of these, as well as to their internal regulation scheme, the general rules analysed in the first part of the present study are also applicable.

By examining the practice besides the applicable rules, we can draw a conclusion as follows. Decision-making for the group operation takes place on a public policy stage, and thus our present conclusions touch upon the system in force at the time of writing this study. In the fields of public utility services, there are active concerns (holdings) operating in the form of public limited companies like: Hungarian Electricity Works plc (Magyar Villamos Művek Zrt.), which as a group integrates nearly 20 separate economic companies through a control contract. Merging the state public utility services into one unified system started with the foundation of The First National Public Utility Service Provider plc (Első Nemzeti Közműszolgáltató Zrt.). A similar concern situation can be observed within the transport section, the Budapest Transport Centre plc (Budapesti Közlekedési Központ Zrt.), which fulfils the task of controlling the transport activities of the capital through the simultaneous joint governing of several companies. Volán Association (Volán Egyesülés) also operates within the transport sector, the associate companies of which are service providers of bus transportation operating in different regions of the country.[101] The municipalities – in the capital and primarily in the cities of county level (e.g. Miskolc, Pécs) – run city management holdings.

VII. Is There a Specific Group Interest in Public Companies?

Examining these companies, we can draw the following conclusions from the point of view of group interest. In the case of city management holdings, it is a typical organizational model to operate with a unified central purchasing system, a finance and a management system, and that they also follow a unified HP-

100 MVM (Hungarian Electricity Works).

101 For instance: DAKK Zrt., ÉNYKK Zrt. (Hungarian regional transport centre companies in the form of plc-s).

policy; in other words, the parent company conducts the full range of the human actions of such companies. These are arranged and performed by the company on a group level. The control agreements include the right for the withdrawal of authority, that is: 'the directorate of the controlling company has the right to withdraw any authority – either occasionally or permanently – from the management of the company under control, by its unilateral written statement and with immediate effect, in which case the action executed by the directorate of the controlling company through withdrawn authority, the thus concluded provision or exerted order directly obliges the company under control along with its employees'.[102] As part of the proper operation subject to the unified business interest, the leading official of the company under control is obliged to carry out the management of the Company-under-Control in accordance with point No 3:55. in § (4) of the Civil Code (Ptk.) upon the basis set by the priority of the ultimate business interest of the acknowledged group of companies as a whole.[103]

Considering the above shown examples and organizational models, it can be declared that in the case of Hungarian public companies it is not unfamiliar, however – in many cases, it has been a successfully implemented legal solution –, to function as an acknowledged group of companies. The legal framework of this is presented by the regulations of public law, on the one hand, and those of the Civil Code, on the other. Ever since the Hungarian change of regime, it has been a frequent subject of ongoing public policy debates how to efficiently arrange the public services of the state and what kind of optimal model can be devised relating to the private entrepreneur's property of the state.

Both the above cases and the areas examined in the previous chapters show that in the case of public companies, regarding group-level functioning, both the regulations of civil law as well as corporate law are eligibly applicable. At the same time, the doubts disclosed therein, the argued standpoints present in the practice of law interpretations and jurisprudence are all still valid. Neither can it be nor shall it be necessary to segment the group interest in public companies. Hereby, we refer to the fact that some judiciary decisions fundamental to universal and not sectorial regulations (e.g. EBD 2013. P. 3.) are also related to public companies.

Nevertheless, as to our view, from one perspective, group interest does manifest differently from general regulations. The group-like cooperation of market players depicts a group interest that can be separated from the interests of

102 Pécs Holding City Property management plc publicized draft on control contract, point: 4.2.1.1. Available at: www.pecsholding.hu.

103 Ibid.: 4.3.2.2. point, and also Miskolc Holding Municipality Property Management plc foundation deed point: 15.3.

the controlling company. Yet, it completely fits into the market players' system of interest (economic companies).

This interest, however, bears a different meaning in public companies. The interest of the controlling company must typically – or ideally – fall in line with the public interest. This public interest is manifested in the organization that manages the proprietorship rights, and also in the status of the proprietor. In the case of the Hungarian National Property Management Company (MNV Zrt.), it is the parliament and government in power who bears the responsibility for making decisions along certain property policies. Behind the decisions of the holdings owned by the municipalities, there is the board of representatives, or, more precisely, the decision-making body who were granted legitimacy at the elections. This point of connection does not only explain the different content of the group interest but the identification of the group interest with the public interest as well. In our view, the question resulting from this is to what extent making any references to the public interest covers the group interest and to what extent the current regulation on group-level cooperation as prescribed by the Civil Code (Ptk.) can be applied to the relations of public companies with such peculiarities.

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Company Groups and Group Interest – the Case of Romania

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Abstract. A company in the Romanian law is a legal person. The classic approach towards legal personality is to consider such structures as entities with a single patrimony and a single interest, subject of legal rights and liabilities. Meanwhile, company groups represent a very frequent form of organizing business activities, which necessitates new legal approaches. Frequently, there is a conflict between the best interest of a member company of the group and the best interest of the company group itself. Is it correct if we proceed as the classic attitude dictates, and give prevalence to the interests of the single company to the detriment of the group? This article focuses on the problems arising from the conflict between the isolated interest of a company and the general interest of the company group in the context of Romanian company law and insolvency law.

Keywords: company group, group interest, duty of care and loyalty, creditor protection, group insolvency, minority shareholders

I. Overview

Company group as legal reality. The company group as such is not expressly recognized in the Romanian *company law*. But there are no doubts that the *company group* is not only a very frequent economic reality in Romania and other states but a legal reality as well due to the legislative evolutions of the past decades.

But the company group, as a *legal reality*, appears especially in *other legal branches* than company law, such as tax law (transfer pricing, VAT groups, truthfulness of intragroup transactions), accounting law (consolidated annual financial statements), competition law, administrative law (special rules on supervision of credit institutions and insurance companies belonging to a group by the supervisory authorities, public procurement law), capital market law,

labour law, and – from a special post-socialist perspective – also in privatization law (because there are specific rules on the privatization of company groups).

Nevertheless, company law operates with such notions as subsidiary, mother company, control, etc., meaning that it creates all the tools necessary for constructing and operating company groups based on the economic liberty of association.[1] But in company law the main or the only scope of the traditional approach is to regulate the company as it is (its internal structure and *modus operandi*), not as a component of a larger structural concept which is the company group. At international level, the group of companies and 'not the single company has become the prevailing form of European large-sized enterprises, which business activity is typically organized and conducted through a network of individual subsidiaries located in several States inside and outside Europe.'[2]

The Rozenblum doctrine. The importance and the necessity to explore the idea of company group also from a company law perspective was raised in the French (criminal) jurisprudence in the context of the Rozenblum case,[3] and it was practically transformed into a 'doctrine', a statement on how such cases should be examined. The traditional company law concept is that the directors of a company must act in the interest of the company. The states generally 'want to ensure the integrity of the management of each subsidiary so that it is governed exclusively in the interest of that company. The main goal and effect is to protect minority shareholders and creditors of the subsidiary.'[4] The Rozenblum case transformed and nuanced this attitude at least partially.

According to the Rozenblum doctrine, if certain conditions are met, it is a legitimate action if the directors of a certain company act in the interest of the company group even if the action itself is to the detriment of the individual group member. As stated in the legal literature, 'the conditions in French law for the safe harbour are: (1) the firm structural establishment of the group, (2) the existence of a coherent group policy, and (3) an equitable distribution of the revenue and the costs of the business among the members of the group. It has been said of the French position that no group transaction is forbidden so long as there is some *quid pro quo*, though not necessarily an exact counterbalance. However, support provided by a group company must not exceed what can reasonably be expected from it, so that where support is beyond the provider's financial capacity, it will be considered unlawful.'[5] In other words, the Rozenblum doctrine represents a

1 According to Art. 45 from the Romanian Constitution, free access of persons to an economic activity, free enterprise, and their exercise under the law shall be guaranteed.

2 Report of the Reflection Group on the Future of EU Company Law.

3 Rozenblum. Cass. crim. Judgement of 4 February 1985, JCP 1986, II. No 20585.

4 The Informal Company Law Expert Group (ICLEG), Report on the recognition of the interest of the group, October 2016. 5.

5 Ferran, Chan Ho 2014. 40.

defence for directors acting in the interest of a company group and at the same time to the detriment of the company they are directing if the specific conditions are met: the group is characterized by capital links between the companies; there is a strong, effective business integration among the companies within the group; financial support for one company to the another must have an economic *quid pro quo* and may not break the balance of mutual commitments between the concerned companies; the support from the company must not exceed its possibilities or create a risk of bankruptcy for the company.[6]

Does the Rozenblum doctrine represent a specific risk for transition economies? It is a serious question if this doctrine is clear enough to be transformed into a general legal rule taken out of its original context (criminal law).[7] For example, in the case of transition economies as Romania was (and to a certain extent still is), it was stated that introducing such a concept as group interest into legislation is dangerous. 'To assess the likely impact of this doctrine in transition economies, it is worth remembering the legacy of the former socialist countries, where the interest of the people or the state prevailed over individual economic or personal interest. Judges, even if well-trained, independent and impartial, will be familiar with this kind of reasoning, and therefore are likely to err on the side of overstating group interest. It seems therefore advisable to caution against the introduction of this doctrine in transition economies. The doctrine may be useful to modify atomistic economic interests once these are fully recognized, but may undermine the very recognition of such interest if introduced prematurely.'[8]

Sincerely, this argument seems artificially created and it is based on a questionable premise never confirmed in the Romanian (group law or, more generally, company law) jurisprudence that somehow a socialist concept on the primacy of general interest over the individual interest creates an actual predisposition for the judges to overstate the interest of company groups and in consequence override the interest of individual companies. There is a *fundamental misunderstanding*. The doctrine and practice of socialist law meant by public interest the specific interest of the communist state and of the Communist Party, and company group interest does not fit into any of those bygone categories.

Having in mind the arguments presented in this introductory part of the analysis, we have to find out if the group interest as such formed a concern for the Romanian legislator and the issue of group interest was or was not dealt with by the Romanian courts.

6 Conac, Enriques, Gelter 1997. 519–520.

7 The committed criminal offence was the abuse of corporate property (*abus de biens sociaux*).

8 Hopt, Pistor 2003, 26. The problem how to draft a legislation based on the Rozenblum doctrine formed the subject of a debate in Poland. For details, see Sołtysiński 2013, 545–546.

II. Company Law and Group Interest

Abuse of corporate property and recognition of group interest. The ideology behind Law No 31/1990 on companies reflects that each company has its self-standing status and own interest. Every company is a self-standing legal entity. But as the real-life situation is not so simple, we have to look into the approach of the criminal law towards the abuse of corporate property. Through Law No 31/1990 on companies, Romania incriminated the abuse of corporate property, stating that 'shall be punishable with imprisonment from 6 months to 3 years or a fine the founder, manager, general manager, director, member of the supervisory board or of the directorate or the company's legal representative … who uses, in bad faith, goods or credit enjoyed by the company, for a purpose contrary to the interests of the company or in his own benefit or to favour another company in which directly or indirectly has interests…' (art. 272 (1) b), Law No. 31/1990).[9] Practically, this is the legal context for the application of the Rozenblum doctrine, and at first sight all the conditions for the necessity of such an approach as stated in the French legal practice are fulfilled.

In reality, if we read further the Romanian legislation, the legal context is totally different compared to the French one. Through Emergency Ordinance 82/2007,[10] the incriminating text was completed with a new paragraph, very important for group interest. According to this addition, the above mentioned conduct is 'not considered a criminal act' if it is committed by the administrator, director, directorate member, or legal representative in the context of treasury operations between the company and other companies controlled by it or other companies controlling the company directly or indirectly (Art. 272 (2), Law No 31/1990). The law does not give a definition for *treasury operations*, but these practically include the management of holdings, liquidities, loans, financial risks, collections, funding, etc. This means an indirect legal recognition of the group interest in the very context in which the Rozenblum doctrine was created.

But the notion of group interest and the practical problems raised by the functioning of company groups seems a little bit wider than the criminal law

9 The French incriminating text is practically identical: "Le fait, pour les gérants, de faire, de mauvaise foi, des biens ou du crédit de la société, un usage qu›ils savent contraire à l'intérêt de celle-ci, à des fins personnelles ou pour favoriser une autre société ou entreprise dans laquelle ils sont intéressés directement ou indirectement" (Code de commerce – Article L241–3, 4°); in English: 'The use by managers of the company's property or credit, in bad faith, in a way that they know is contrary to the interests of the company, for personal purposes or to encourage another company or undertaking in which they are directly or indirectly involved.' See also Article L242–6 from the Code de commerce. The sanctions under the French law are much more severe than in the case of Romania: imprisonment up to 5 years and a fine of 375,000 euros.

10 An emergency ordinance is a regulation with legal force enacted by the government under extraordinary circumstances and approved/modified/rejected *post factum* by the parliament.

context which gave birth to the Rozenblum doctrine and is reflected in the Romanian legislation.

Abuse of majority and denial of group interest. Outside the criminal law provisions of Law No 31/1990 on companies, the issue of the existence and extent of group interest is not so evident anymore.

The control of the parent company is exercised from a legal point of view and formally through the general assembly, and in consequence the real direction in the context of everyday operation and effective control is practically realized through informal means. How does this theoretical autonomy of the subordinated group member company work in jurisprudence? We can check how some core features of group law work in practice, and we cannot say that there is no serious friction between the functional and patrimonial autonomy of a subsidiary (member company of the group), as a self-standing legal entity, and the control exercised by the parent.

For example, in a recent court case involving practically a (simple) cross-border group, the court denied the concept of group interest. The parent needed a bank loan and the subsidiary, a joint-stock company (*societate pe acțiuni*) had immovable property to guarantee that bank loan. There were some minority shareholders as well, a financial investor and some minor investors (the financial investor being actually a specific entity created through the mass privatization programme). In the general assembly of the subsidiary, the guarantee was approved, with a very large majority. Practically, only one minority shareholder, the financial investor voted against the proposal.

This minority shareholder filed a case to the court, demanding the annulment of the general assembly decision, adducing the fact that the decision serves solely the interest of the parent company and not at all the interest of the company itself. The court ruled in the favour of that minority shareholder, based on the legal text which states that *all shareholders (in this case, the parent company) must exercise their rights with good faith, respecting the rights and legitimate interests of the company (in this case, the subsidiary) and of the other shareholders*.[11] Practically, the decision is based on the *abuse of majority* argument.[12]

The isolated interest of the subsidiary won the battle against the group interest, meaning that under no circumstance the fact that a subsidiary belongs to a company group does not empower the management or even the majority of shareholders to act contrary to the interest of the subsidiary (or of the minority shareholders). We cannot establish the precise content of this approach: from now on, such actions in favour of the parent must be adopted unanimously, being necessary that in all cases all minority shareholders must vote in favour of such decision. There is

11 Law No 31/1990 on companies, Art. 136/1.

12 Târgu-Mureş Court of Appeals, Decision No 1984/2013.

an undeniable legal uncertainty. As it was correctly stated, such uncertain rules or interpretations are not 'user-friendly'; practically, we do not know what the rules require, prohibit, or permit. 'The rules are not accessible, comprehensive, comprehensible or sufficiently determinate… As a result, law cannot perform its guiding function… These obstacles are intensified because of the need for planning to maintain an economic activity. Any business or occupation requires planning that includes forecasting of future legal consequences and assessment of economic alternatives…'[13]

The jurisprudential approach is not fully adapted to the economic needs of a company group, it is not flexible enough, and it produces negative economic effects. There must be a way to reconcile group interest with the protection of the minority shareholders. For example, there is a possibility to only partially affect the immovables to guarantee the bank loan, proportionally with the percentage of the parent in the share capital of that company, giving in this way a specific guarantee to minority shareholders.

Conflict of interests. Law No 31/1990 on companies states also that if a shareholder has regarding a certain issue, either personally or as agent of another person, an interest contrary to the interest of the company, that shareholder must abstain from deliberations on that question[14] and the shareholder breaching this abstention rule will be liable for damages caused to the company if without his vote the required majority would not have been obtained. From the point of view of group interest, this means that the parent company cannot act in its own interest at the general assembly of the shareholders of the subsidiary, but it must respect exclusively and fully the interest of the subsidiary.

Duty of care and diligence and the denial of group interest. The representatives of a company must act according to the duty of care and diligence, with loyalty and in the interest of the company.[15] This duty is respected if, when making a business judgement, the representative reasonably believes that he/she is acting in the interest of the company and on the basis of adequate information.[16] This approach recognizes that not all of the actions of the representatives are in the benefit of the company, but a representative is protected from personal liability if 'decisions are made by disinterested directors acting on an informed basis, in good faith and in the honest belief that their actions serve the corporation's best interest'.[17] This rule is very important, otherwise company representatives will

13 Ávila 2016. 21–22.
14 Law No 31/1990 on companies, Art. 127.
15 Law No 31/1990 on companies, Art. 144/1.
16 High Court of Cassation and Justice, commercial section, Decision No 2827/2011.
17 Shultz 2001. 226.

take a risk-averse attitude in the context in which successful business activity necessitates a certain level of responsible risk-taking. As it was stated, 'the core responsibility of directors is to weigh risk against reward. This is an art, not a science.'[18]

As a consequence, one representative of the subsidiary company must act in the (sole and isolated) interest of the company, otherwise the business judgement rule is infringed.

Freedom of establishment and denial of group interest. If a company group is facilitated by the freedom of establishment rule of the EU law, there are for sure problems with the Romanian rule according to which a person can be the sole member of only one single-member limited liability company.[19]

In jurisprudence, the issue was raised that this limitation is applicable only to Romania, taking into consideration the territorial scope of the law. We do not have a unitary jurisprudence, but most of the interpretations tend to decipher the law stating that this interdiction has a general effect. For example, a German company establishes a single-member limited liability company in Bulgaria as a wholly-owned subsidiary. But this Bulgarian limited liability company cannot establish a single-member sub-subsidiary in Romania due to this rule. The rule is very formal because the German parent company and the Bulgarian limited liability company can establish together a limited liability company in Romania.

Meanwhile, the Romanian trade register cannot check if there is another single-member company of the German parent in another member state, so if the German parent comes alone to establish a Romanian single-member limited liability company, there are no enforceable limitations (which conduct is theoretically a criminal offence because the German parent must declare that it fulfils all the legal conditions to establish a Romanian single-member company).

Therefore, this rule can be seen as an impediment of group formation and an indirect denial of group interest.

The right to give instructions and the denial and group interest. In the present legislative frame, a single-member subsidiary is possible only if this subsidiary is organized as a limited liability company (*societate cu răspundere limitată*). If a joint-stock company is the form needed, another person must be involved: as in the previous example, another group member in most of the cases.[20]

The parent, as a sole member of the limited liability company or in the context of the joint-stock company the parent shareholders exercise the powers

18 Bevans 266.

19 Law No 31/1990 on companies, art. 14.

20 By exception, the state and the local governments can establish single-member joint-stock companies.

of the general assembly or through the general assembly. This tool is a totally different direction mechanism compared to the direct right to give instructions to the subsidiary company executives, not recognized by the law. The right to give instructions can be continuously exercised, outside the formal context of a general assembly, contrary to the idea that 'shareholders should not micro-manage the company'.[21]

Such instructions undoubtedly exist in fact, but the question is if we need to formalize them. Perhaps, the answer is yes, for the following reasons:

– if the instructions exist anyway, it is better for the law to follow the realities, and create a framework for the instructions;

– for better and clearer rules for the sake of an effective management of the company group; practically, for the reason of legal certainty;

– for the executives of the subsidiary, whose rules on responsibility would be clarified in this way.

In case of refusal to act as instructed, the most energetic tool of the parent company is to dismiss the executive who rejected the (informal) instruction. In reality, this is a complicated tool for the parent. Theoretically, this dismissal is *ad nutum*, no specific conditions or justifications are needed. But the text of the law specifies that if the dismissal is without justification, the dismissed executive is entitled to damages. The dismissed company executive can easily argue that his dismissal is without any justification because he has rejected the instruction rightfully, relying on the best interest of the subsidiary and based on his obligations of duty of care and loyalty toward the subsidiary, as shown above.

There is no effective protection outside the criminal law provisions for the subsidiary executive who acts in the interest of the group but against the isolated interest of the subsidiary. To regulate the right to give instruction is not an easy task. If we recognize expressly in the legislation the existence of this right, then practically the parent company will be integrated in the decision-making process of the subsidiary as an 'organ' of the subsidiary, and therefore must hold a certain responsibility in the case of the subsidiary's insolvency. (The best option would be a regulation on the European Single-Member Company, at least for cross-border groups).

Competition law context. Recently, there have been formulated legislative proposals to amend Law No 21/1996 on competition.[22] According to this proposal, the Competition Council (*Consiliul Concurenței* – the Romanian competition authority) may apply the sanction also for the parent company for the activity of a subsidiary with separate legal personality in case in which the subsidiary

21 The Informal Company Law Expert Group (ICLEG), Report on the recognition of the interest of the group, October 2016, 5.

22 Draft law amending and supplementing Law competition, Competition Council, June 4, 2015.

does not decide independently its own conduct on the market but carries out the instructions given to it by the parent company. According to this proposal, the parent company and the subsidiary are treated as one and the same economic entity, single undertaking if the conditions are met, in concordance with the EU case law. In the EU competition law jurisprudence, it is considered that the conduct of a subsidiary may be imputed to the parent company in particular where, although having a separate legal personality, that subsidiary does not decide independently upon its own conduct on the market but carries out, in all material respects, the instructions given to it by the parent company, having regard in particular to the economic, organizational, and legal links between those two legal entities.[23]

Direct involvement in the infringement of competition law rules of the parent company was not required by the text of the proposal, and in the case of a wholly-owned subsidiary a presumption of lack of independent decision-making was to be introduced. This proposal was eventually not approved.

Need for reform? Some reform is certainly needed. If we recognize the right of the parent to give instructions to the directors, the outcome will be very interesting. Practically, the company group will become a certain legal institution of Romanian company law. But we must emphasize the goals of such reform. Two antagonistic approaches are possible.

First, the reform can propose stricter responsibility rules for company groups, militating for much stronger creditor protection, for the liability of the parent for the subsidiary and vice versa. I really cannot agree with the maximalist versions of this approach. If we follow this line of reform, the essence of company, of limited liability, of separate legal personality will fade, and in my opinion such a maximalist approach has a paralysing effect on risk-taking and finally on economic development. This will lead to the creation of informal groups with no visible connection between members, practically to the creation of dissimulated groups. The Romanian Code of Fiscal Procedure regulates the joint and several liability of members or shareholders of the over-indebted fiscal debtor (a legal person) by alienating or hiding, with bad faith, under any form the debtor's assets (Art. 25) – text applicable also for company groups. The fiscal authority has the power to issue an enforceable decision in this sense and only an *ex post* judiciary control is possible to check if the legal conditions set up for this measure are met or not.

23 Judgments in *Akzo Nobel and Others* v *Commission*, C-97/08 P, EU:C:2009:536, paragraph 58; *Alliance One International and Standard Commercial Tobacco* v *Commission* and *Commission* v *Alliance One International and Others*, C-628/10 P and C-14/11 P, EU:C:2012:479, paragraph 43; and *Areva and Others* v *Commission*, C-247/11 P and C-253/11 P, EU:C:2014:257, paragraph 30, *Fresh Del Monte Produce Inc. v European Commission and European Commission v Fresh Del Monte Produce Inc.*, C-293/13 P and C-294/13 P, paragraph 75.

Second, a much balanced approach is possible. In this context, I could welcome the approach proposing the adoption of a European directive or recommendation on company groups and group interest. The scope is not to introduce more rules on creditor protection but to create a tool for economic development and a legal tool for better company management. The issue of liability and protection of minority shareholders must be raised in context and not as a goal in itself. The awaited directive on the European Single-Member (Private Limited Liability) Company would or could clarify also some of the uncertainties.[24]

III. Insolvency Law and Group Interest

Specific insolvency rules for company groups. For the first time, a set of specific rules regarding insolvency procedures for company groups were adopted through *Law No 85/2014 on the procedures of insolvency prevention and insolvency,* the third comprehensive post-socialist insolvency regulation.[25] This is the first Romanian law with explicit rules for company groups.[26] Through this law, Romania is among the first EU member states which introduce such legislation regarding the insolvency of company groups.[27]

The notion of company group in insolvency law. According to the insolvency act, the notion of *company group* means two or more companies linked by control and/or qualified ownership. The *group member* can be any of the companies belonging to the group, whether parent or controlled member of the group; controlled member of the group is the company controlled by the parent company.

Control is the ability to determine or to exercise a dominant influence, directly or indirectly, on the financial and operating policy of a company or on the decisions of corporate organs. A person shall be regarded as holding control when:

a) holds directly or indirectly a qualified ownership of at least 40% of the voting rights of that company and any other partner or shareholder directly or indirectly does not hold a higher percentage of voting rights;

b) holds directly or indirectly the majority of voting rights at the general meetings of that company;

24 Proposal for a Directive of the European Parliament and of the Council on single-member private limited liability companies, Brussels, 9.4.2014 COM 212 final.

25 For an English language general overview of the new law, see Glodeanu 2014, 355–392.

26 For the general context, see Mevorach 2007, 179–194; Hirte 2008, 213–236; also see the 'UNCITRAL Legislative Guide on Insolvency Law. Part Three: Treatment of Enterprise Groups in Insolvency – 2010' (therefore: UNCITRAL Guide 2010).

27 Şarcane 2014. 836.

c) as a partner or shareholder of that company has the power to appoint or remove a majority of the members of the administrative, management, or supervisory bodies.

Qualified ownership means the fraction between 20% and 50% owned by a person in another company.

If these conditions are met, the rules on company group insolvency will be applicable to the companies in question. At the request of any interested party, the syndic judge (the specialized insolvency judge) may verify the applicability of these specific rules.

Results of the insolvency law reform regarding company groups. All common rules on insolvency procedures are applicable accordingly in case of insolvency of company groups (or, more precisely, of companies belonging to a company group), but subject to derogation through the provisions of art-s 184–203 of Law No 85/2014, which constitutes a set of special regulations for company groups.

According to the approach of the Romanian legislator, the *coordination* of insolvency procedures is necessary in case that two or more companies belonging to a group go insolvent. Can an insolvency application be issued against the group itself? Of course not, but a creditor can issue, under the provisions of Law No 85/2014, a joint application against group members or against all the members of a group. Similarly, two or more members of a company group can request jointly the opening of insolvency proceedings.

Practically, these rules are applicable only when at least two members of a company group are insolvent, and from the point of view of the creditor both members must have the minimum amount of overdue debt towards the same creditor (the threshold of minimum 40,000 lei, certain, liquid, and due for more than 60 days). If the request is made jointly by the company group members, the minimum amount of debt can be owed to different creditors, but all company group members must register at least a single debt of 40,000 lei, no matter the total amount of the obligations of the debtor company.

Also, in the case of joint application, a member of the company group that is not insolvent or in imminent insolvency, in order to avoid a later opening of insolvency proceedings, may join this joint application. In this case, the joint application for the opening insolvency proceedings shall be approved by the general assembly of associates/shareholders of the non-insolvent group member.

Coordination of insolvency proceedings of company group members. The rules introduced through Law No 85/2014 create the links between insolvency procedures of company group members for a better management of insolvency cases.

The competent court will be the (county-level) tribunal where the seat of the parent company is registered or, alternatively, the tribunal from the seat of the company member with the highest turnover according to the latest published financial statements for all members of the company group. Therefore, the same court will deal with the insolvency proceedings of any group member.

A separate file will be opened for each debtor (member of the group), but the same syndic judge will be appointed to deal with all the cases (if there are separate requests, the syndic judge designated by the random distribution system in the first registered case will be appointed in all of the insolvency proceedings of companies belonging to the same group). This is practically a derogation from the random distribution mechanism of the court cases. Therefore, the joint application for opening insolvency proceedings is the request made by the debtor or creditor, aiming to open concurrently insolvency proceedings of two or more members of the same group of companies, in separate cases, but under the jurisdiction of the same syndic judge. The approach is one of coordination of these procedures instead of consolidation. According to the 'UNCITRAL Legislative Guide on Insolvency Law. Part Three: Treatment of Enterprise Groups in Insolvency', *procedural coordination* means the coordination of the administration of two or more insolvency proceedings in respect of enterprise group members. Each of those members, including its assets and liabilities, remains separate and distinct. The alternative solution would be the *substantive consolidation*, when the assets and liabilities of two or more enterprise group members are treated as if they were part of a single insolvency estate.[28] Romania opted for the first system, i.e. procedural coordination.

The creditor which has a claim against an insolvent debtor, member of company group, jointly and severally liable with another insolvent member company of the same group (for example, in the case of consortiums formed by company group members or in the case when a company group member guaranteed the debts as a jointly and severally liable surety for another member company) can practically participate in both procedures.

Also, the receivers must cooperate in case there are fraudulent transactions and any of the receivers, initiating an annulment case,[29] must inform the other receivers. Under the rules of mandatory collaboration, the receivers will provide the other receivers with the information required to develop compatible and coordinated reorganization plans.

Effects of the joint application. The joint application for insolvency triggers a lot of specific effects, mainly in the interest of a better administration of the procedure.

28 UNCITRAL Guide 2010. 2.

29 For details on treatment of fraudulent transactions in insolvency, see Glodeanu 2014, 380–382.

Creditors' committees nominated for each group member company subject to insolvency proceedings will meet at least quarterly, the main goal being to make recommendations on the activity of the debtor companies and reorganization plans. These joint meetings serve as a coordination tool for the procedures from the point of view of the creditors. Also, the same special administrator (shareholder's representative) must be nominated for each group member by the general meetings of the debtor, and therefore the same person will represent the interest of the shareholders in all parallel insolvency procedures.

If creditors holding at least 50% of the debts are identical for each member of the company group, the management of the affairs of each company will be assigned to the same receiver (judicial administrator) or, when this condition is not met, the receivers must cooperate in the context of a cooperation protocol agreed in 10 days from the start of the procedure and approved by the syndic judge, under the direction of a coordinating receiver.[30] Any of the receivers appointed in the insolvency proceedings of a group member may attend meetings of creditors and creditors' committees of any of the other insolvent group members. Moreover, any receiver can propose a reorganization plan also in the insolvency procedures of the other group members.

As a measure of creditor protection, the law states that all intra-group claims arising from transactions concluded *before* the date of opening of insolvency proceedings are not treated as regular claims but as *subordinated claims* (with minimal chances for payment),[31] which is not justified in my opinion if the claims resulted from the normal or ordinary course of business transactions. Unfortunately, this approach has no facilitating effect for group reorganization. Of course, there is a chance of intra-group fraud, but the fraudulent transactions must be treated separately and the simple existence of the company group, which is nowadays a perfectly normal legal construction to organize business activity, cannot be sanctioned in this way. This tool of creditor protection is at the same time and evidently in the disadvantage of the own creditors of the intra-group creditor company.

There is no clear rule for the problem if company group insolvency rules must be applied in the case when only one member company of the group is insolvent. If not, the intra-group debts maintain their normal rank. The jurisprudence must clarify this aspect. According to my opinion, the company group rules must be applicable even in the case when a single member of the group is insolvent, otherwise the rules have a discriminatory nature: when one company is insolvent, the intra-group claims maintain their rank; when two or more group members are insolvent, the intra-group claims are demoted to a lower rank. I must conclude

30 The law does not determine the rules of nomination of the coordinating receiver, but the syndic judge has the powers to determine which one of the receivers will act in this specific quality.

31 Şarcane 2014. 845.

that the application of group insolvency rules are not preconditioned to a joint request to open insolvency procedures of two or more company group members.[32] The practical consequence will be the use of avoidance methods to simulate intra-group claims as claims owned by third parties. There is the question as to whether collaterals constituted by the insolvent group member, for a claim of another group member, prevent or not the demotion of that claim. Will that claim preserve or lose its special status as a guaranteed claim? In my opinion, those claims have to be treated as guaranteed ones.

Instead, a group member may enter into a loan agreement with another member of the group *after* the opening of the insolvency proceedings to support the activity of the debtor within the period of observation or to support the reorganization plan with the consent of the creditors' committee. In this case, the lending group member will have a claim against the debtor with a higher and usual priority of the claims of such nature, ahead of ordinary unsecured creditors. As it was stated in the UNCITRAL Guide, 'the particular interest of a group member providing finance may relate more to the insolvency outcome for the group as a whole (including that member) than to commercial considerations of profit or short-term gains, especially where there is a high degree of integration or reliance between the businesses of the group members'.[33]

A group member can guarantee a loan agreement entered into with a third party, with the agreement of the creditors' committee.

Procedural aspects. The debtor(s) are obliged to submit to the case file a complete list comprising the members of the company group, whether they are insolvent or not, a description on how the group is functioning, and the list of ongoing contracts concluded between group members.

Group interest and insolvency. The group interest legally exists if certain legal rules are providing priority for the group against the individual and isolated interest of group members. The set of rules analysed above reflects in some way such a legislative approach. We can identify some traces of a specific group interest (joint application for insolvency for group members, coordination of the procedures, the possibility for a non-insolvent group member to join the insolvency proceedings to avoid its own insolvency in the future, methods to support the insolvent group member, etc.). But there is a fragile balance between creditor protection, on the one hand, and group interest, on the other hand, resulting in the lack of unitary approach. If the group reorganization has to be facilitated, the

32 In this sense, the UNCITRAL Guide states that 'it is desirable, therefore, that an insolvency law not establish a joint application as a prerequisite for procedural coordination'. See UNCITRAL Guide 2010, 22.

33 UNCITRAL Guide 2010. 44.

demotion of pre-insolvency intra-group claims will surely have negative effects, and there is no incentive for a non-insolvent group member to join the insolvency procedures under such circumstances. Practically, the ranking demotion of pre-insolvency intra-group claims infringes heavily the group interest, which is not counterbalanced through other legal provisions indirectly and faintly recognizing and protecting such an interest.

IV. Conclusions

We can observe that there are conflicting approaches towards group interest. A reform introducing group interest into company law, based on a unitary approach, aiming to ease the creation and operation of company groups while balancing the interest of minority shareholders and creditors as well, seems necessary, especially in the case of Romania, an EU Member State which was rightfully considered as having 'uncertain laws' on group interest.[34]

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The Standard of Compensation for Taken Foreign Property in Major International Investment Dispute Cases

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Abstract. During the last few decades, there were several disputes between foreign investors and host countries worldwide about the standard of compensation for taken foreign property. The opinion of international tribunals regarding this issue is not always in accord. There is only consensus that there should be some kind of compensation for taken property. This article examines the issue of standard of compensation related to the taking of foreign property in the case-law of most important international tribunals, including the Iran–United States Claims Tribunal, the ICSID, and the NAFTA tribunals. It tries to find out if there is a common agreement in international law on this issue.

Keywords: expropriation of foreign property, compensation, standard, Iran–United States Claims Tribunal, ICSID, NAFTA

I. Introduction

The right of sovereign states to exercise power on their territory and to take (expropriate or nationalize) foreign property is recognized in international law. That is to say, we proceed from the assumption that the majority of states recognize the lawfulness of expropriation or nationalization, provided the taking is non-discriminatory, there is a public purpose, and there is compensation for the taken property.[1] Indeed, the majority of states recognize that some form of compensation is due for taken foreign property. The dispute is usually about the

1 This is also recognized by many constitutions of independent states, several international documents, international arbitral awards, and by the majority of authors dealing with the issue. Bergmann 1997. 47; Dixon 1993. 213–215; Brownlie 1998. 535. However, it should be mentioned that there are less and less genuine expropriation claims in developed countries, as most cases are 'based on the BITs' "treatment" provisions. These cases center around state intervention into the market' (Nagy 2016 I. 11).

standard of compensation.[2] This article will examine some of the most important cases related to the issue of standard of compensation. Thus, we are going to scrutinize, above all, the case-law of the Iran–United States Claims Tribunal and those of ICSID and NAFTA tribunals. We will try to find out what was the most accepted compensation standard in international law during the last few decades.

II. The Case-Law of the Iran–United States Claims Tribunal

The work of the Iran–United States Claims Tribunal represents one of the most important bodies of international case-law on the issue of compensation for expropriated foreign property.[3] The Tribunal has been established following the Iranian revolution and the 'hostage crisis', when the Government of the United States froze Iranian assets worth over USD 12 billion.[4] With the mediation of Algeria, the parties (the United States and Iran) agreed to adhere to two accords made by the Algerian Government (General Declaration[5] and Claims Settlement

2 …since, according to international law, every violation of an international obligation creates the duty to make reparation. The principle of restitution or compensation is also included in the draft Articles on Responsibility of States for internationally wrongful acts of the International Law Commission:

'A state responsible for an internationally wrongful act is under an obligation to make restitution, that is, to re-establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:
(a) is not materially impossible;
(b) does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation.

The state responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, insofar as such damage is not made good by restitution.

The compensation shall cover any financially assessable damage including loss of profits insofar as it is established.' (art-s 35 and 36 of draft articles on Responsibility of States for internationally wrongful acts adopted by the International Law Commission at its fifty-third session (2001); UN Info page (visited on Sep. 28, 2015) <http://www.un.org/law/ilc/texts/state_responsibility/responsibilityfra.htm>); See also Barrera 2011. 81, Bergmann 1997. 24.

3 However, it should be mentioned that some authors, such as Sornarajah, are of the opinion that the decisions of the Tribunal should not have binding precedential value because such bodies and their decisions are usually the result of political agreements (Sornarajah 2004. 380). As opposed to Sornarajah, based on our research regarding international case-law and academic writings related to investment protection, we agree with Lillich and Magraw, who argue that decisions like those of the Iran–United States Claims Tribunal are observed and invoked by international lawyers (Lillich et al. 1998. 37). On the work of the Tribunal, see generally: Caron–Crook (eds) 2000, Lillich et al. 1998, Mouri 1994, Westberg 1991, Ratmatullah 1990, Aldrich 1996.

4 Lillich et al. 1998. 2–8.

5 Pirrie 1985. 3–8, Lillich et al. 1998. 11–13.

Declaration[6]).[7] These documents established a tribunal that aimed to settle disputes between the parties.[8] This Tribunal applied at least five different sources of international law: (1) the Claims Settlement Declaration (and other agreements related to the Algiers Accords),[9] (2) the Treaty of Amity (Treaty) between Iran and the United States,[10] (3) other international agreements (as subsidiary means[11]),[12] (4) customary international law,[13] and (5) general principles of law.[14,15] Regarding the applicable law, in the opinion of Mouri, the Tribunal was hesitant to establish it, except in a few cases.[16] Bergmann, a German scholar, opines that the basis of the decisions of the Tribunal was not the international law but primarily the Treaty of Amity between the United States and Iran.[17] Moreover, Mouri argues that the Tribunal was generally of the opinion that, regarding the standard of compensation, in the early stages of the Tribunal's work, the international law was applied. However, later there were many awards which found that the Treaty of Amity is the applicable *lex specialis*.[18] In some cases, the Tribunal even took the standpoint that the United Nations General Assembly Resolutions are not directly binding upon states, and thus, generally, are not evidence of customary law.[19] Furthermore, they set 'ambiguous' standards concerning the amount of compensation.[20] The Tribunal also rejected, as guidance for customary international law, the settlement practices of states and investors (or other states) in the case of investment disputes.[21] The reason for this might be that such settlements are usually the result of bargaining and are not based on legal norms and procedures. The Tribunal mostly relied on legal writing and judicial and arbitral precedents.[22] On the other hand, Matti Pellonpaa and Fitzmaurice argue that the Treaty of Amity was regarded as the *lex specialis* to be followed by the Tribunal.

6 Pirrie 1985. 9–12.
7 Mouri 1994. 1–6, Lillich et al. 1998. 11–13.
8 As the General Declaration formulates: 'to terminate all litigation as between the government of each party and the nationals of the other, and to bring about the settlement and termination of all such claims through binding arbitration' (Pirrie 1985. 3, Lillich et al. 1998. 13–22).
9 E.g. in the cases of Islamic Republic of Iran v United States, 251, 266 and Sedco v National Iranian Oil Company, 23.
10 E.g. in the case Amoco International Financial Corp. v Islamic Republic of Iran, 189, 223.
11 Lillich et al. 1998. 27.
12 E.g. like interpreting the 1930 Hague Convention Concerning certain questions relating to the conflict of nationality laws. See also Lillich et al. 1998. 27.
13 E.g. in the case Amoco International Financial Corp. v Islamic Republic of Iran, 189, 223.
14 E.g. in the case Pomeroy v Islamic Republic of Iran, 372, 380.
15 Lillich et al. 1998. 27.
16 Mouri 1994. 296.
17 Bergmann 1997. 64.
18 Mouri 1994. 297, 301, 306.
19 E.g. the Sedco case. See Pellonpaa–Fitzmaurice 1988. 110–111.
20 Id.
21 Pellonpaa–Fitzmaurice 1988. 53, 111.
22 Id. at 112.

The Tribunal maybe wanted to avoid the uncertainty of international law and to have a firm legal framework for its decisions, an international instrument that is accepted by all the parties involved in the dispute. At the same time, we might presume that the Tribunal did not want to deprive its decisions of international recognition, and therefore it obviously found that its decisions are in line with international law and standards. For example, concerning expropriation issues, the Tribunal did not conceive Treaty standards different from the standards of customary international law.[23]

The Tribunal was not unanimous concerning the issue of the standard of compensation.[24] Accordingly, concerning the issue of the standard of compensation, awards were either based on international law or on the Treaty of Amity. The former, delivered on the basis of international law, can be further categorized: awards that applied the *standard of appropriate compensation*[25] and those that applied the *full compensation*[26] *standard*.[27]

For example, in the Sola Tiles award,[28] the Tribunal applied the *appropriate compensation standard*. In 1982, Sola Tiles, Inc., owner of Simat Ltd (incorporated in Iran in 1975), filed a claim against the Government of Iran for damages, and it asked for a compensation of USD 3.2 million (including lost profits and goodwill) that arose from the expropriation of the assets of Simat Ltd.[29] Simat Ltd was importing and reselling ceramic tiles.[30] The Israeli owner of Simat Ltd established and registered Sola Tiles, Inc. in California in May 1979 with two American citizens.[31] On May 25, 1979, all the assets of Simat Ltd were transferred to Sola Tiles, Inc.[32] The claimant alleged that from June 1979 'various steps were taken by the local Provisional Revolutionary Committee [of Iran] to interfere with the business of Simat'. According to the claimant, the interference eventually amounted to taking of control and expropriation of the company's assets.[33] Iran denied the expropriation and, at the same time, disputed the valuation submitted

23 Lillich et al. 1998. 187, 208.
24 Mouri 1994. 351, Lillich et al. 1998. 325–327.
25 Mouri is of the opinion that 'the term *appropriate* denotes that the standard should strike a balance between the interests of the expropriating and expropriated parties and be able to fairly, justly, equitably or appropriately evaluate the circumstances pertinent to each particular case, which automatically brings into play the points of view of the expropriating States, together with their expectations' (Mouri 1994. 364).
26 Mouri further states that 'the term[s] … *full* [is] usually looked at from the point of view of the price or the value that is required by the owner to replace the property taken' (Mouri 1994. 364).
27 Id. 363.
28 Sola Tiles, Inc. v Islamic Republic of Iran, 235.
29 Id. para. 1 and 3.
30 Id. para. 2.
31 Id. para. 4.
32 Id. para. 5.
33 Id. para. 3.

by the claimant.[34] The Tribunal accepted the argument of the claimant that its assets had been expropriated. Regarding the issue of valuation, the Tribunal was of the opinion that the compensation should be based on the *fair market value* of the company.[35] Regarding the valuation method, the Tribunal opined that valuation should not be based only on the *going-concern value*, but other circumstances should also be taken into account. The reason for this was an evidentiary problem, namely that the claimant had difficulties to access the complete documentation related to its property. First, the Tribunal took into consideration the estimation of physical assets and accounts receivable of Simat by business partners who wanted to acquire part of the company shortly before the revolution.[36] Actually, the opinion of these business partners was the starting point for the Tribunal's own assessment.[37] The Tribunal gave an estimate of physical assets, accounts receivable, and the expropriated cash.[38] The claimant claimed compensation also for the goodwill and lost future profits of the company.[39] However, the Tribunal, when deciding on this issue, took into consideration the changed (deteriorated) business environment in Iran – that had affected also newly established businesses –, and decided not to award lost future profits or goodwill.[40] The Tribunal called the compensation awarded 'a global assessment of the compensation due, representing the value of Simat's business'.[41] The Tribunal also awarded interest. Although, there are many decisions of the Iran–United States Claims Tribunal in which the Tribunal awarded interest, this award is important because it explicitly tells us what standards and methods were used for the calculation of the awarded interest. The interest was calculated at a rate:

> …based approximately on the amount that it would have been able to earn had it had the funds available to invest in a form of commercial investment in common use in its own state. Six-month certificates of deposit in the United States are such a form of investment for which average interest rates are available from an authoritative official source, the Federal Reserve Bulletin.[42]

According to the award, the respondent had to pay to the claimant USD 625,000 plus simple interest at the rate of 10.75 percent per annum from January 1, 1980

34 Id. para. 7.
35 Id. para. 52.
36 Id. para. 54–56.
37 Id. para. 57.
38 Id. para. 60.
39 Id. para. 61.
40 Id. para. 62–64.
41 Id. para. 65.
42 Id. para. 66.

up to and including the date on which the escrow agent instructed the depositary bank to effect payment out of the security account, plus costs of USD 20,000.[43] In this case, the Tribunal stated that *appropriate compensation standard* has a widespread use, noting at the same time that in its opinion the word *appropriate* in fact means *adequate*.[44]

A good example of an award requiring *full* compensation is the American International Group, Inc.[45] case. In 1979, all insurance companies operating in Iran were nationalized by a special law on nationalization of insurance companies. One of these was Iran America Insurance Corporation, which was organized under the laws of Iran in 1974. American International Life Insurance Company, a company incorporated in Delaware, and three other companies, wholly-owned subsidiaries of American International Group, Inc., had 35 percent of shares in Iran America. American International Group, Inc. claimed compensation for the taken investment (USD 39 million). Regarding the issue of valuation, the Tribunal was of the opinion that it should be based on the *fair market value* of the business interest in the company of the claimant on the date of the nationalization. However, the problem that the Tribunal faced when it wanted to determine the *fair market value* was that there was no active market for the shares of Iran America. The Tribunal concluded that in such case the best solution is to value the company as a going concern, taking into consideration all the relevant factors, such as the opinion of independent appraisers, prior changes in the 'general political, social, and economic conditions' that might have effect on the business prospects of the Company. It took into consideration not only the net book value of the company but also the goodwill and future prospects and profits (had the company been allowed to continue its business under its former management). Based on all these factors, the Tribunal made an approximation of the value of the Company.[46] The Tribunal awarded USD 7.1 million plus 'simple interest' at the annual rate of 8.5 percent from the date of the expropriation up to and including the date on which the escrow agent instructed the depositary bank to effect payment of the award.[47] In an interlocutory award, the Tribunal concluded that before the Second World War customary international law required *full* compensation, that is to say, 'compensation equivalent to the full value of the property taken'. However, the Tribunal admitted that since then this standard had been challenged by many countries and legal commentators.[48]

43 Id. para. 68.
44 Id. para. 44–49.
45 American International Group, Inc. v Islamic Republic of Iran, para. 96.
46 Id.
47 Mouri 1994. 371.
48 This is supported, for example, by lump sum agreements concluded where compensation usually amounted only to the half value or even less of the property taken, and by United Nations Resolutions of the sixties and seventies (Pellonpaa–Fitzmaurice 1988. 104–105).

The first award to support the premise that standard of compensation, as established in the Treaty of Amity, has to prevail as *lex specialis* was in the INA Corporation[49] case.[50] Following the Iranian revolution, Iran took (with the law on nationalization of insurance companies) the stake of INA Corporation in Sharg insurance company registered in Iran. INA claimed USD 285,000 representing what it alleged to be the 'going-concern value of its shares', together with interest at 17 percent. The Tribunal stated that the claimant is entitled to the *fair market value* of its shares in Sharg.[51] The Tribunal found that the price INA paid in an arm's length transaction for the shares one year before the nationalization represented the *fair market value* of the shares of Sharg as a going concern. The claimant, because of the relatively small amount of the claim, did not claim compensation for future profits (the valuation by experts would have been too costly having in mind the small amount of the claimed compensation), and the Tribunal accepted this. The Tribunal obliged Iran to pay USD 285,000 together with simple interest thereon at 8.5 percent *per annum* from the date of the expropriation up to and including the date of the award.[52] This case also shows that the Tribunal accepted, as one of the valuation methods, the *going-concern* valuation method.

The Treaty of Amity itself contains the *standard of just compensation*, which is defined by the Treaty as 'full equivalent of the property taken'. The Tribunal applied a wide property concept, meaning that, when determining the value of the property, the Tribunal took into consideration also the goodwill and the future profitability (or expected profits) of the taken enterprise.[53,54] Hence, the Tribunal applied in many instances the *standard of just compensation*, interpreting it as *full equivalent* of the property taken.[55] Good examples are cases like the case of Thomas Earl Payne[56] and Phelps Dodge Corporation.[57]

In the former case, the claimant, Payne (American citizen), had ownership interest in Irantronics and Berkeh companies. These companies were dealing with electronic equipment and they were incorporated in Iran.[58] In 1980, the

49 INA Corporation v Islamic Republic of Iran, para. 373.

50 Mouri 1994. 378.

51 In this case, the Tribunal defined *fair market value* as 'the amount which a willing buyer would have paid to a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalization itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares'.

52 INA Corporation v Islamic Republic of Iran 373.

53 Pellonpaa–Fitzmaurice 1988. 53, 58.

54 Mouri 1994. 378; cf.: Art. 4 (2) of the Treaty of Amity, Economic Relations, and Consular Rights, signed on 15 August 1955 and entered into force on 16 June 1957 between Iran and the United States of America. 8 U.S.T. 899, 284, U.N.T.S. No 4132, para. 933.

55 Mouri 1994. 380–381.

56 Payne v Iran, para. 3.

57 Phelps Dodge Corp. v Iran, 121.

58 Payne v Iran, para. 3–5.

management of the company was taken over by a manager appointed by the Minister of Commerce of Iran.[59] The claimant claimed compensation of USD 7.2 million for his ownership interests in Irantronics and Berkeh, plus interest and costs.[60] The Tribunal applied the *standard of just compensation*, meaning compensation for the *full* equivalent of the taken property, based on its *fair market value*.[61] The Tribunal established that, at the time of the taking, the two companies were going concerns. Thus, it valued their shares on the *fair market value* basis. However, it took into consideration the effects of the revolution prior to the taking of the companies on the value of their shares, debts, and tax liabilities.[62] The Tribunal awarded USD 900,000 plus simple interest at the rate of 11.25 percent *per annum*, calculated from the date of expropriation up to and including the date on which the escrow agent instructed the depositary bank to effect the payment out of the security account.[63]

In the latter case, the claimant, Phelps Dodge Corporation, a company from New York, became one of the founders of an Iranian company, SICAB. SICAB was established to manufacture wire and cable products in Iran.[64] Following the revolution, SICAB was expropriated, and Phelps Dodge claimed damages (USD 7.5 million) plus interest and costs.[65] When determining the compensation, the Tribunal accepted the standard of *just* compensation, which should be counted on the basis of *full* equivalent of the taken property.[66] However, based on the factual evidence presented to the Tribunal by the parties (SICAB without the support of the service companies like Phelps Dodge would have had no business prospects), the Tribunal refused to value the company as a going concern (that is to say, it refused to value goodwill and future profits). It decided that the claimant, Phelps Dodge, is entitled to compensation that equals its investment and not more.[67] The Tribunal awarded USD 2,437,860 and 'simple interest' at the rate of 11.25 percent per annum to the claimant, from the date of expropriation up to and including the date on which the escrow agent instructed the depositary bank to effect payment out of the security account.[68]

59 Id. para. 8.

60 Id. para. 1 and 2.

61 Id. para. 29–30. The Tribunal defined fair market value as an 'amount which a willing buyer would have paid a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalization itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares'.

62 Id. para. 31.

63 Id. para. 42.

64 Phelps Dodge Corp. v Iran, 121, para. 1–4.

65 Id. para. 29.

66 Id. para. 28–29.

67 Id. para. 30–31.

68 Id. para. 34.

In both of the previous cases, the Tribunal scrutinized profoundly all the facts of the cases to determine the *just* compensation, that is to say, the *full* equivalent of the taken property based on its *fair market value*. In our opinion, it follows that there cannot be a uniform formula for determining *just* compensation. Such compensation is determined by taking into account all the circumstances of single cases.

Examining the latest award of the Tribunal in the Frederica Lincoln Riahi v the Government of the Islamic Republic of Iran case, we can say that in this award the Tribunal invoked all the above mentioned milestone cases before reaching the final award.[69] In this case, Frederica Lincoln Riahi filed a claim in 1982 against the Government of Iran, in which she sought compensation for equity interests in a number of companies expropriated in 1980 by Iran.[70] Concerning the time when the claim is considered to have arisen, the Tribunal held that in its previous decisions it had been established that an expropriation claim is considered to arise on the date of the taking.[71] The claimant based some of its claims on *de facto* taking by the Government, that is to say, on creeping expropriation of Riahi's property.[72] Therefore, the Tribunal also argued that:

> In situations where the alleged expropriation is carried out through a series of measures interfering with the enjoyment of the claimant's property rights, the cause of action is deemed to have arisen on the date when the interference, attributable to the state, ripens into an irreversible deprivation of those rights, rather than on the date when those measures began. The point of time at which interference ripens into a taking depends on the circumstances of each case and does not require the transfer of legal title.[73]

Regarding the standard of compensation, in the Frederica Lincoln Riahi case, the Tribunal referred to previous decisions in which it had stated that, according to the Treaty of Amity and customary international law, taking requires compensation equal to the *full* equivalent of the value of the interests in the property taken.[74] Concerning valuation standard, in this case, the Tribunal invoked previous decisions, such as establishing that the valuation of the expropriated property should be made on the basis of the *fair market value*. This was defined in the INA case as:

69 Frederica Lincoln Riahi v The Government of the Islamic Republic of Iran.
70 Id. para. 1 and 2.
71 Id. para. 42.
72 Id. para. 343.
73 Id. para. 344.
74 Id. para. 394.

> [T]he amount which a willing buyer would have paid a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalization itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares.[75]

The Tribunal stated, on the other hand, that 'prior changes in the general political, social and economic conditions which might have affected the enterprise's business prospects as of the date the enterprise was taken should be considered'.[76] Here, the Tribunal considered the effects of the Islamic Revolution, and acknowledged the possible influence of the turbulence on the economy, that is to say, on the share prices of the company.[77] Since the shares were not traded freely on an active and free market, the Tribunal used different methods to determine the price that a reasonable buyer would be willing to pay for the company's shares in a free-market transaction.[78] In the opinion of the Tribunal, the company was a profitable, ongoing business at the time of the expropriation, and therefore it decided to value it as a going concern.[79] At this point, the Tribunal referred to the Amoco case, where it was held that 'a going-concern value encompasses not only the physical and financial assets of the undertaking' but also the 'intangible valuables which contribute to its earning power', such as: contractual rights, goodwill, and commercial prospects.[80] The Tribunal also noted that it is a settled rule of international law that compensation for speculative or uncertain damage cannot be awarded.[81]

Based on our research and some of the most important cases of the Tribunal discussed above, we can support the opinion of scholars like Pellonpaa, Fritzmaurice, and Bergmann, who concluded on the bases of the case-law that the general tendency in the decisions of the Iran Claims Tribunal is to award compensation not only for the lost material property but, in many cases, also for the lost future profits.[82] In addition, Pellonpaa and Fritzmaurice state that the standard of *full* compensation is still the rule of customary international law.[83]

Regarding valuation methods,[84] as we can see from the cases examined, the Tribunal applied various methods. One of the most widely used methods was the valuation based on *fair market value* on the date of taking in cases when the

75 Id.
76 Id.
77 Id. para. 393–394.
78 Id. para. 447.
79 Id. para. 448.
80 Id. para. 448–454.
81 Id. para. 450.
82 Bergmann 1997. 68, Pellonpaa–Fitzmaurice 1988. 53, 123–126.
83 Id.
84 Valuation method is the technique of determining the value of the taken property.

foreign investors' equity interest in an enterprise was taken.[85] *Fair market value* was defined as 'the price that a willing buyer would pay to a willing seller in circumstances in which each had good information, each desired to maximise his financial gain, and neither was under duress or threat'.[86] Another important valuation method in the practice of the Tribunal's work was the valuation as *going concern*.[87] This was defined as the full value of the property, business, or rights in question as an income-producing asset. It also includes lost future profits and goodwill, as we could see above.[88] However, in some cases, other methods were also employed, such as *discounted cash flow*[89] method of valuation, methods based on *liquidation value*,[90] *net book value*,[91] and *replacement value*.[92,93]

As to the form of payment, *effectiveness* of payment was insured for claimants by the practice of the Tribunal. The Algerian Declaration established so-called 'security accounts' from which payments can be made to successful claimants in United States dollars.[94] Concerning the time of payment, the practice of the Tribunal suggests that *prompt* payment is not a condition of the legality of the taking, however, in general, it was of the opinion that the compensation should

85 Pellonpaa–Fitzmaurice1988. 53, 131.

86 Id.

87 Id. 134. *Going concern* is defined by Encarta World English Dictionary as 'a business that is operating successfully and is likely to continue to do so, especially when considered as an asset to which a value can be assigned' (visited on Nov. 22, 2015) <http://encarta.msn.com/encnet/features/dictionary/DictionaryResults.aspx?refid=561547195>. InvestorWords Dictionary defines it as: 'The idea that a company will continue to operate indefinitely, and will not go out of business and liquidate its assets. For this to happen, the company must be able to generate and/or raise enough resources to stay operational' (visited on Nov. 22, 2015) <http://www.InvestorWords.com/cgi-bin/getword.cgi?2189>.

88 Pellonpaa–Fitzmaurice 1988. 53, 134.

89 According to Investopedia Dictionary, *discounted cash flow* is a valuation method used to estimate the attractiveness of an investment opportunity. It uses future free cash flow projections, and discounts them to arrive at a present value, which is used to evaluate the potential for investment – most often discounted by the weighted average cost of capital. If the value arrived at through discounted cash flow analysis is lower than the current cost of the investment, the opportunity may be a good one. Investopedia Dictionary (visited on Oct. 5, 2015) <http://www.investopedia.com/terms/d/dcf.asp>.

90 According to InvestorWords Dictionary, *liquidation value* is the estimated amount of money that an asset or company could quickly be sold for, such as if it were to go out of business. If the liquidation value per share for a company is less than the current share price, then it usually means that the company should go out of business (or that the market is misvaluing the stock), although this is uncommon. InvestorWords Dictionary (visited on Oct. 5, 2013) <http://www.InvestorWords.com/2836/liquidation_value.html>.

91 According to InvestorWords Dictionary, the *net value* of an asset equals to its original cost (its book value) minus depreciation and amortization. InvestorWords Dictionary (visited on Oct. 5, 2015) <http://www.InvestorWords.com/2836/net_value.html>.

92 According to InvestorWords Dictionary, replacement value is the value of an asset as determined by the estimated cost of replacing it. InvestorWords Dictionary (visited on Oct. 5, 2015) <http://www.InvestorWords.com/4184/replacement_value.html>.

93 Pellonpaa–Fitzmaurice 1988. 139, 149, 160, 163.

94 Pirrie 1985. 5–6.

be paid at the time of the taking or it should be accompanied with interest from the time of the taking.[95]

We are of the opinion that the Tribunal tried to compensate the investors as much as possible for their taken property, regardless of what term was used for the standard of compensation.[96] Comparing the standard of compensation in the case-law of the Iran–United States Claims Tribunal to the standard used in other international cases examined in this work, it can be said that the Tribunal offers a high standard of compensation, protecting investors who have lost their property in Iran. At the same time, it should be noted that, many times, the Tribunal based its valuation on approximation of the value. The reason for this might be a tendency in the decisions of the Tribunal, according to which it tries to take into consideration all the circumstances that had effect on the taking of the property.

III. ICSID Case-Law

There are many ICSID arbitration cases related to expropriation of foreign investments. Because of lack of space, we examine only the most important ones of these cases, where the issue of compensation was raised. One of these is the Compania del Desarrollo v the Republic of Costa Rica, where the claimant – a company incorporated in the Republic of Costa Rica with majority ownership of United States citizens – initiated arbitration in 1995 against the Republic of Costa Rica, related to an expropriation dispute.[97] The dispute was about the amount of the compensation for the expropriated property of the company. In 1978, Costa Rica expropriated a coastline property, bought by the claimant earlier for developing a tourist resort, invoking environmental reasons. It offered USD 1.9 million as a compensation for the expropriation; however, the company did not accept it.[98] This was followed by long proceedings in front of Costa Rican Courts without any success.[99] Costa Rica was not willing to refer the matter to international arbitration until it was forced by the United States to do so (the United States threatened with non-approval of international financial aids to the country).[100] Finally, the issue was brought to ICSID arbitration. The claimant estimated that USD 41.2 million is the *fair* and *full* (based on *fair market value*) compensation

95 Pellonpaa–Fitzmaurice 1988. 53, 131.

96 Whenever it was possible, it valued the companies taken as going concern, taking into account the goodwill and the lost future profits. It based its valuation on the *fair market value* of the taken property.

97 Compania del Desarrollo de Santa Elena S.A. v Republic of Costa Rica, para. 1. See also Piernas (ed.) 2007. 221.

98 Compania del Desarrollo de Santa Elena S.A. v Republic of Costa Rica, para. 3, 15–17.

99 Id. para. 19–26.

100 Id. para. 22–26. ICSID has jurisdiction over a case only if the parties to the dispute consent in writing to submit it to the Centre. Nagy 2016 II. 241.

for the property,[101] while the respondent's estimation of the current *fair market value* was USD 2.9 million.[102] The respondent also took into consideration the 'current' environmental regulations (entered into force after the expropriation) that restricted the use of the property for commercial purposes.[103] The claimant contested that the arbitral Tribunal take into account, when estimating the value of the property, any regulation that entered into force after the expropriation decree was issued.[104] Thus, the central issue of the arbitration was to decide the amount of compensation to be paid to Compania del Desarrollo.[105] The arbitral Tribunal agreed with the parties that the *fair market value* on the date of expropriation of the property should be paid as compensation.[106] Thus, the Tribunal was of the opinion that 'full compensation for the fair market value of the property, i.e., what a willing buyer would pay to a willing seller' has to be paid.[107] However, it stated that the environmental character of the expropriation does not affect the compensation.[108] Even so, the Tribunal had to establish the exact date of the expropriation first. Regarding this issue, the Tribunal examined different definitions of *de facto* expropriation, since it was of the opinion that a property had been expropriated when the effect of the measures taken by the state was 'to deprive the owner of title, possession or access to the benefit and economic use of his property'.[109] Finally, the Tribunal concluded that, notwithstanding that the claimant remained in the possession of the property, the expropriation occurred on the date when the expropriating governmental decree was issued.[110] Therefore, the value of the property on this date was taken into consideration.[111] As there were only two appraisals available to the Tribunal (one from each party from 1978), it made an approximation based on these valuations, and came to the value of USD 4.1 million.[112] This was corrected with the interest counted from the time of the expropriation. Moreover, the Tribunal did not want to use *full compound interest*[113] because the claimant remained in possession. At the same

101 Id. para. 29.
102 Id. para. 35.
103 Id.
104 Id. para. 37.
105 Id. para. 54.
106 Id. para. 70.
107 Id. para. 73.
108 Id. para. 71.
109 Id. para. 77.
110 May 5, 1978. Id. para. 80.
111 Id. para. 83.
112 Id. para. 90.
113 Merriam-Webster Online Dictionary defines the term as: 'interest computed on the sum of an original principal and accrued interest' (visited on Mar. 12, 2015) <http://www.m-w.com/cgi-bin/dictionary?book=Dictionary&va=compound+interest>; Money Glossary defines it as: 'interest rate in which the interest is calculated not only on the initial principal but also the accumulated interest of prior periods' (visited on Mar. 12, 2015) <http://www.moneyglossary.com/?w=Compound+Interest>.

time, as the claimant could use neither the property for development purposes nor the amount of compensation for a long time, the Tribunal did not want to award simple interest either.[114] Consequently, the Tribunal awarded compound interest 'adjusted by taking into account all the relevant factors',[115] and thus the final amount was USD 16 million.[116]

In another case, Tecmed, a company with registered seat in Spain, claimed compensation from the Mexican Government for expropriation.[117] The claimant's claim, that is to say, the estimated market value of the investment, was USD 52 million, based on the *discounted cash flow* calculation method.[118] The respondent objected this method because in its opinion the investment operated for a too short period of time as a going business, and it requested the calculation of damages based on 'the investment made, upon which the investment's market value would be determined'.[119] The Tribunal also took into consideration the money paid for the investment at the tender, USD 4 million.[120] After the examination of the facts, the Tribunal also concluded that, because of the short period of operation of the investment and the lack of objective data, the discounted cash flow calculation method should be disregarded.[121] The agreement between the parties, on which the arbitration was based, stated in its Article 5.2 that in case of expropriation:

> [C]ompensation shall be equivalent to the fair market value of the expropriated investment immediately before the time when the expropriation took place, was decided, announced or made known to the public […] valuation criteria shall be determined pursuant to the laws in force applicable in the territory of the Contracting Party receiving the investment.[122]

Therefore, the Tribunal examined the Mexican law on expropriation, which stated that the compensation shall indemnify for the 'commercial value of the expropriated property, which in the case of real property shall not be less than the

114 Compania del Desarrollo, para. 105.
115 Id. para. 106.
116 Id. para. 107.
117 Award in Tecnicas Medioambientales Tecmed, S.A. v United Mexican States, para. 183.
118 Id. under para. 185. Home Glossary defines 'discounted cash flow' as: 'A method to estimate the value of a real estate investment, which emphasizes after-tax cash flows and the return on the invested dollars discounted over time to reflect a discounted yield. The value of the real estate investment is the present worth of the future after-tax cash flows from the investment, discounted at the investor's desired rate of return' (visited on Jan. 25, 2015) <http://www.yourwebassistant.net/glossary/d7.htm#discounted_cash_flow >.
119 Id. However, the respondent did not miss to challenge the result of the discounted cash flow method with the estimation of its own expert witnesses between USD 1.8 and 2.1 million.
120 Id. para. 186.
121 Id.
122 Id. para. 187.

tax value'.[123] The Tribunal interpreted this requirement as compensation based on the *market value*.[124] When determining the value of the expropriated investment, the starting point for the Tribunal was the price for which the investment was acquired at the tender.[125] Besides, it also considered additional investments made by the claimant[126] and the net income of the investment for one additional year.[127] This latter basically covered managerial and organizational skills and goodwill.[128] Finally, the Tribunal awarded USD 5.5 million.[129] The award required *effective* and *full* payment.[130] It also prescribed compound interest (at an annual rate of 6 percent) until the payment from the date of the expropriation (this is actually the date on which the licence to operate should have been prolonged).[131,132]

These cases confirmed the *fair market value* standard's application in practice. On the basis of these cases, we can also conclude that the principle *of restitutio in integrum*, in the case of taking foreign property, is accepted by international tribunals like the ICSID. In our opinion, ICSID offers an effective way to the investors to get fair (here we use the term subjectively) compensation based on *fair market value* of the property taken.

IV. NAFTA Case-Law

The North American Free Trade Agreement does not say explicitly that *prompt*, *adequate*, and *effective* compensation is required when foreign property is taken; however, with its provisions, it covers this standard indirectly. According to the Agreement, 'compensation shall be paid without delay and be fully realizable'.[133] The Agreement also guarantees free transferability of the compensation, immediately upon payment.[134] It contains an explicit formula – *fair market value* – for determining compensation:

123 Id.
124 Id. 188.
125 Id. para. 191. Neither the respondent nor the claimant challenged this method for determining the *fair market value*.
126 Id. para. 195. However, it is a procedural matter. It should be mentioned that the court recognized as additional investment only investments that were supported by documentary evidence.
127 Id. para. 194.
128 Id.
129 Id. para. 201.
130 Id.
131 Id. para. 39.
132 Id. 201.
133 Art. 1110 (3) of the North American Free Trade Agreement, NAFTA Secretariat Info page (visited on Apr. 5, 2015) <http://www.nafta-sec-alena.org/english/index.htm>.
134 Id. art. 1110 (6).

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ('date of expropriation'), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going-concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.[135]

The Agreement also makes precise provisions on the interest rates related to late payment, that is to say, for the period between the date of the expropriation and the payment date (because of the requirement of *prompt* payment). It provides that if the payment of compensation is done in G7 currency, the compensation has to bear a *commercially reasonable rate* from the date of the expropriation until the date of the actual payment.[136] If the payment is done in other than G7 currency, the Agreement provides the following, regarding the issue of the interest to be paid:

> […] the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.[137]

For example, in the Metalclad case, the Tribunal stated that on the basis of its provisions,[138] NAFTA clearly supports the inclusion of interest in an award.[139] In this case, the Tribunal proceeded from the assumption that the investor completely lost its investment.[140] Both parties accepted to calculate the compensation on the basis of the *fair market value* standard.[141] However, they offered different methods for the calculation of this value. Metalclad suggested two alternative methods for the calculation of the compensation. One was the discounted cash flow analyses of future profits to establish the *fair market value*.[142] By this

135 Id. art. 1110 (2).
136 Id. art. 1110 (4) (5).
137 Id. art. 1110 (4) (5).
138 Id. art. 1135 (1).
139 Metalclad v Mexico, para. 128.
140 Id. para. 113. It should be noted that damages were sought under NAFTA Art. 1105; however, the court stated that counting damages (compensation) under the provisions of Art. 1110 would be the same.
141 Id. para. 114–116.
142 Id. para. 114.

approach, Metalclad came up with an amount of USD 90 million.[143] The other one was the valuation of the actual investment made by the company.[144] Under this, it reached approximately USD 20 to 25 million. Mexico objected to the discounted cash flow method, claiming that it was not applicable because the expropriated company was not a going concern.[145] However, it offered a method of market capitalization,[146] which would result between USD 13 to 15 million.[147] At the same time, Mexico agreed with the second method proposed by Metalclad, however, referring to it as 'direct investment value approach', and reaching only between USD 3 to 4 million.[148] The Tribunal rejected the first method suggested by the claimant. The investment was never operative, and therefore the Tribunal found that the application of the discounted cash flow analysis would not be appropriate. In the opinion of the Tribunal, for the application of this method, it is needed that the company operate for a sufficiently long period that gives appropriate basis for determining the estimated future profits, subject to discounted cash flow analysis.[149] In such a case, the value of the goodwill of the company also has to be taken into consideration.[150] However, in the opinion of the Tribunal, this was not the case with the Metalclad investment.[151] Thus, the Tribunal used the second method offered by the parties, that is to say, the *fair market value* method. When considering the issue of lost profits, it was of the opinion that they can be awarded; however, the claimant had the burden of proof, that is to say, it had to provide a realistic estimate of lost profits.[152] The Tribunal also emphasized that, when making the award, it accepted the principles of the Chorzow Factory case, that is to say, that the award has to re-establish the *status quo ante*.[153] Regarding the issue of interest, the Tribunal was of the opinion that interest should be part of the compensation and it should be counted from the date when the state became 'internationally responsible' for the taking.[154] In this particular case, from the date on which Metalclad's application for construction permit was 'wrongly denied'.[155] The court determined a six percent per annum

143 Id.
144 Id.
145 Id. para. 116.
146 Money Glossary defines it as: 'The total dollar value of all outstanding shares. Computed as shares times current market price' (visited on Jan. 8, 2015) <http://www.moneyglossary.com/?w=Market+capitalization>; See also Bloomberg Financial Glossary (visited on Jan. 8, 2015) <http://www.bloomberg.com/analysis/glossary/bfglosm.htm#market_capitalization>.
147 Metalclad v Mexico, para. 116.
148 Id. para. 117.
149 Id. para. 119–121.
150 Id. para. 120.
151 Id. para. 121.
152 Id. para. 122.
153 Id.
154 Id. para. 128.
155 Id.

interest rate.[156] Thus, the Tribunal finally awarded USD 16.6 million plus interests to Metalclad.[157]

Another interesting ICSID case is the S. D. Mayers case, in which, in contrast to the previous case, the Tribunal did not find that the regulation (i.e. the export ban) amounted to expropriation. In addition, the Tribunal refused to apply to breaches of Article 1102 ('national treatment') and Article 1105 ('minimum standard of treatment') the principles laid down in Article 1110 of NAFTA concerning expropriation.[158] In the opinion of the Tribunal, the standard of Article 1110 of NAFTA, like that of *fair market value*, was 'expressly attached […] to expropriations' by the drafters of NAFTA.[159] Furthermore, it was of the opinion that in cases that do not involve expropriation drafters intentionally left it open for tribunals to determine compensation standards.[160] In such cases, tribunals have to take into consideration 'the specific circumstances of the case', the principles of international law, and the provisions of NAFTA.[161] Theoretically, the Tribunal did not exclude the applicability of the *fair market value* standard; however, it was of the opinion that it was not applicable for this very case.[162] It stated that the suitable international law standard for this case could be found in the Chorzow Factory case.[163] That is to say, 'the compensation should undo the material harm inflicted by a breach of an international obligation'.[164] In his concurrent opinion, one of the members of the panel, Bryan P. Schwartz, brings on interesting arguments. He claims that 'fair market value might, in some cases, be less than fair value. An investment might be worth more to the investor for various reasons, including synergies within its overall operations, than it is to third parties'. He also argues that the finding that the expropriation has happened, on the other hand, should not reduce the amount of compensation that is ought to be awarded. He further states that the cumulative principle applies within Chapter 11 of NAFTA. When a government denies to investors the protection assured by specific provisions of Chapter 11, compensation may be required above and beyond that which would apply in the ordinary case of a lawful expropriation. However, he says that:

> […] even if we had found that the export ban did amount to an expropriation under the terms of Article 1110, that finding would not necessarily have

156 Id.
157 Id. para. 131.
158 S. D. Myers partial award para. 305, 306.
159 Id. para. 307.
160 Id. para. 309.
161 Id.
162 Id.
163 Id. para. 311.
164 Id. para. 315.

> provided a basis for awarding any compensation above and beyond that already recoverable under the terms of Article 1102 [National Treatment].[165]

In connection with this case, we have noticed that the Tribunal placed great emphasis on the factual proof of the claims when determining the amount of compensation (supporting documentation, e.g. tax filing, etc.).[166]

The NAFTA case-law also supports the assumption that the valuation standard of *fair market value* is the most accepted in international law, and also that the principle of *in integrum restitutio* forms the basis of awards in expropriation cases where the main issue is compensation. This proves the constantly rising standard of investment protection in the world, which might be the result of the growing importance of private property protection or simply the fact that international competition for investments has become tighter with the globalization, and therefore investment recipient countries try to offer the most in every field.

V. Conclusions

Examining the development of international case-law, we have come to the conclusion that there is no uniform practice in the field of compensation standards related to taking of foreign investment. There are a number of cases that refer to the standard of the Chorzow Factory case, in which it was stated that the reparation must re-establish the *status quo ante*. This means usually *full* compensation, based on *fair market value*, which is, in our opinion, the most objective valuation standard. In some cases, compensation is awarded for lost future profits as well, and this solution can be equitable; however, it is difficult to fairly calculate the lost profits. All in all, the examination of the case-law shows that the *prompt*, *adequate*, and *effective* standard prevails in practice; however, there is no full accord in the practice of tribunals, especially on *adequate* standard. At the same time, we may not forget that many international conventions contain provisions that formally do not comply with the above said and that many countries of the world formally do not accept it. Therefore, it would be helpful to work out a more detailed and precise system of compensation on the international level. We are convinced that making clear conditions for compensation can be beneficial for all the parties.

165 Concurrent opinion of Bryan P. Schwartz. (Lexis database, 1 Asper Rev. Intl Bus. and Trade Law at 337, 406, 407).

166 Metalclad v Mexico case, para. 124.

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Group Interest in European Company Law: an Overview[1]

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Abstract. Cross-border groups are important for the further integration of the European economy and they have become increasingly common. However, they must be run according to diverging national rules, which makes management cumbersome. One important issue is whether the subsidiary's management may take into account the interest of the group as a whole or whether only the subsidiary's interest is relevant. Currently, Member States follow completely different approaches, which has led to a call for harmonization. This was picked up by the Commission in its 2012 Action Plan on company law. This article sketches the development in recent years both on the academic and the practical level, and identifies the core issues.

Keywords: European company law, group interest, groups of companies

I. Introduction

Groups composed of numerous individual companies are important players in economic reality. Each of these companies is a separate legal entity entering into legal relations with employees and other business partners; each is responsible towards its creditors, both contractual and in tort. Conversely, group members are not jointly and severally liable for the debts of the group as a whole; under general rules of civil and company law, there is no collective responsibility for the liabilities of the entire group.

1 This paper is based on a lecture delivered on 20 November 2015 at the conference 'Group Interest in Central and Eastern European Company Law' at the National University for Public Service, Budapest. Only indispensable footnotes have been added. In the meantime a Commission expert group, or which the author is a member, has published a report on the issue (Informal Company Law Expert Group 2016), which on many points mirrors positions taken in this paper.

This situation sits well with general precepts of company law, at least as long as another of its buttresses is respected: each company, which is a member of the group, is managed autonomously and its management takes into account only its own interest. That brings civil responsibility and decision-making power into line, thereby avoiding the externalization of costs.

Of course, that is not the reality in most corporate groups as we know them. Very often, decisions are not taken in the interest of the subsidiary but in the interest of the group – which usually means the interest of the parent company. And these decisions are not taken by the management of the subsidiary but in the parent company, and then communicated as wishes, group guidelines, or outright instructions to the subsidiary's management. Such actions may be good for the group as a whole and will probably also benefit the subsidiary; however, they may be detrimental to the company's creditors, any minority shareholders, and other stakeholders. Two examples may suffice to illustrate the issue:

– As a general rule, members of a group specialize in certain tasks; such specialization may be regional as in the example of a bank subsidiary in Austria, which is tasked by its parent company, an Italian bank, to run the group's CEE business out of Vienna. If at a later stage a new lucrative market in the region becomes accessible, the Italian parent may have an interest to run that business itself or through another of its subsidiaries. From a group perspective, legitimate reasons may exist, e.g. more efficient procedures in the company elected to run the business or cultural bonds due to common historical roots. However, from the Austrian subsidiary's perspective, this is a lost business opportunity. The issue will not be pressing for creditors as long as the Austrian subsidiary stays solvent; from the point of view of minority shareholders in the subsidiary, such a decision, however, will decrease the value of their shares.

– Under a cash-pool agreement, all companies in a group transfer their excess liquidity to one company in the group; this cash-pool manager, usually a special purpose vehicle, centrally manages these reserves. In practice, such agreements are increasingly common, also across borders in the single market. They carry at least two advantages: intra-group loans can be arranged easily (which decreases the need for outside finance) and banks will provide better conditions due to the higher volumes involved. The subsidiary will be able to participate in these advantages. As a downside, each subsidiary advancing money to the manager is extending credit to another group company, which may not be in its best interest, especially if the group is entering into crisis. Therefore, the subsidiary may want to ensure that the system contains sufficient safeguards to mitigate these risks; these safeguards will come at a price, usually by limiting the effectiveness of the system from a purely commercial viewpoint or at least by making its operation more cumbersome. In extreme cases, it may be in the best interest of the subsidiary not to participate in such a system at all.

Looking at the matter more closely, two different issues are involved, on which each legislator will have to take a decision:

– May the subsidiary's management take measures which are in the best interest of the group as a whole but not of the subsidiary? Obviously, any affirmative answer has to be nuanced and has to identify the circumstances under which management may do so. That question is central for the subsidiary's management, as it will delineate the danger of incurring civil and/or criminal liability. Therefore, the answer directly influences the ability of the parent company to run the group as an entity, as directors most probably will be hesitant to implement measures detrimental to the subsidiary at the price of becoming personally liable.

– This clarifies whether the directors can follow the parent company's instructions which are in the interest of the group but not of the subsidiary. It does not follow, however, that the directors must follow such instructions by the parent. Such an obligation may be in the parent's interest, although it is probably not necessary, as the absence of any personal liability is likely to make the subsidiary's management compliant with the parent's wishes.

The answers to these questions vary widely between jurisdictions. To a large extent, this is not only an issue for national law as groups these days operate not in single Member States but across the European Union. From the point of view of the parent company, diverging rules in different Member States encumber effective group management as the parent will have to respect the company law rules of each subsidiary. Harmonized rules would enable the group to use the same yardstick irrespective of the applicable company law. Thus, on a very superficial level, there are good arguments for harmonizing the divergent national approaches on the issue.

This paper does not purport to analyse all these issues in detail, but it provides an overview of recent developments in the field. For that purpose, it first takes a brief look at the different approaches taken in the Member States before turning to recent developments on the European level. The paper closes by giving some indications as to legislative choices for any further action on the European level.

II. The National Dimension

As already indicated, national rules on this issue differ widely. Some countries recognize that decisions by the subsidiary may, under certain circumstances, be taken in the interest of the group, even if, judged on their own, they may be detrimental to the subsidiary (e.g. France); others (e.g. Germany, at least outside of contractual groups) do not recognize the interest of the group in such situations. The issue is of importance as managers of the subsidiary may be exposed to (criminal or civil) liability if they do not act in line with the national regulations.

For the purpose of a general overview and disregarding finer points of law,[2] Member States may be categorized into three groups:[3]

– The first group takes a very strict approach and, generally speaking, follows the German model of company law. Some countries, e.g. Germany, have (partially) codified their group law, others, e.g. Austria, use general precepts of company law. The most distinguishing characteristic is the parent company's duty to compensate its subsidiary for any losses it has incurred due to unfavourable instructions by the parent. As a compensation, a general quid pro quo is not sufficient; rather, the parent has to bestow a benefit on the subsidiary, and under most jurisdictions within a short time period. Although lots of differences between the national regimes remain, this concept is hardwired into the national legal cultures and may only be relaxed with the agreement of all members of the company or with wholly-owned subsidiaries; however, even in these situations, liability may re-appear in the subsidiary's insolvency. Generally speaking, these Member States do not recognize the interest of the group as a justifier for decisions to the detriment of the subsidiary.

– A second group takes a more lenient approach and recognizes the group interest at least to some extent. The most prominent example is the French *Rozenblum* doctrine,[4] which has been developed by the courts in the context of prosecution for abuse of corporate assets in criminal law, but is applicable to the civil liability of the directors of the subsidiary as well, while the right to give directions to the subsidiary's management is not an issue. This doctrine provides a safe harbour from liability if four conditions are met: (i) the company is part of a group with capital links between companies, which also integrates the businesses within a coherent group policy, (ii) the directors act in the belief to further the common interest of the group, (iii) there is no grossly inadequate compensation, and (iv) the action should not exceed the financial capability of the company, i.e. bring about its insolvency. Typically, under such a rule, a more general quid pro quo is sufficient in order to meet the criterion (iii); such a consideration may also be non-monetary and expectations for future compensation may be sufficient. This French model has been quite successful in recent times, as a number of countries have introduced legislative rules with similar effects (e.g. Italy[5] and the Czech Republic[6]) and in others case-law has developed in this direction (e.g. Spain[7]).

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2 I am fully aware that the following categorization is oversimplifying the issue; however, for the present purpose, i.e. showing the basic differences between national approaches, this very broad brush seems sufficient.

3 The following categorization is based on Conac 2013. 194, 199 et seq.

4 Court of cassation, Criminal Chamber, 4 February 1985, *Rozenblum* and *Allouche*, D. 1985, P. 478.

5 Art. 2497 Codice Civile.

6 Sec. 71 et seq. of Law No 90/2012 on commercial companies and cooperatives.

7 Cf. Tribunal Supremo, Sala de lo Civil, Sentencia 695/2015 of 11 December 2015.

– Similar to this last group, but with a different starting point, has been the development in Nordic countries[8] and countries in the common law tradition. Among others, UK law traditionally recognizes that shareholders are the ultimate decision-makers in the company; from that point of view, recognition of the group interest, i.e. of the dominant shareholder, is logical. The necessary mechanisms for the protection of shareholders and creditors are provided by other institutes, e.g. the remedies for unfair prejudice[9] or wrongful trading.[10]

Thus, on a national level, one can observe a shift towards some recognition of the group interest in recent times. This development has also had some impact on the European discussion.

III. The European Development

1. Forerunners

To the best of my knowledge, the issue of group interest was raised academically for the first time in the 1990s by a group of scholars, the Forum Europaeum on Group Law. They recommended introducing a modified *Rozenblum* doctrine on the European level.[11] Similarly, in 2002, the High-Level Group of Company Law Experts ('*Winter*-group') recommended adopting a framework rule for groups addressing various issues of group law, inter alia, allowing managers of a group company to adopt a co-ordinated group policy, provided that the interests of creditors of each company are effectively protected and that there is a fair balance of burdens and advantages over time for each company's (outside) shareholder.[12]

The idea then was dormant for some years. However, in 2011, the Reflection Group on the Future of EU Company Law,[13] which had been installed by the European Commission to map the road ahead after the failure of the SPE, cautiously encouraged the Commission to consider issuing a recommendation with a yardstick for the management of a subsidiary by recognizing the interest of the group. Details of such a piece of legislation were deliberately left open, presumably because the Reflection Group could not reach a common viewpoint on these issues.

8 For the Nordic owner-oriented corporate Governance structure, cf. Lekval 2014. 52 et seq.
9 Sec. 994 et seq. UK Companies Act 2006.
10 Sec. 214 UK Insolvency Act 1986.
11 Forum Europaeum on Group Law 2000. 165.
12 High-Level Group of Company Law Experts 2002.
13 Reflection Group 2011.

2. Action Plan 2012

As a result, in 2012, the Commission launched a Consultation on the Future of European Company Law,[14] which, inter alia, contained a question as to the recognition of group interest. The response was rather favourable even if a bit lukewarm and unbalanced as to region and to profession.[15] This encouraged the Commission to include the issue in its 2012 Company Law Action Plan:[16] It announced an initiative 'in 2014' to improve, inter alia,[17] the recognition of the concept of 'group interest'. This was taken up by various organizations close to the business community.[18]

At this stage, it is worthwhile to look at some reasons for the increasing importance of the issue at the European level. At least three different aspects seem to be significant in this respect:

– First, over the last decades, we have been witnessing a slow shift of focus. Historically, group law concentrated on the subsidiary and the protection of its creditors and (minority) shareholders. However, these days, group law is (also) understood as enabling law,[19] which should foster the formation and management of cross-border groups and thereby enhance the integration of markets in the European Union. The main instrument lies in the reduction of the cost of cross-border activities via subsidiaries. One important aspect is the harmonization of the rules on group interest as a single set of rules on that issue will help in organizing European cross-border groups along the same lines; additionally, recognizing the group interest as a justification for actions by the subsidiary will facilitate giving (formal or informal) directions to the management of the parent company. Of course, this may necessitate rules on the protection of shareholders and creditors; however, these will not be the purpose of such legislation but a constraint on the main aim of enabling the parent company to run the group efficiently.

– Second, in the field of financial services, legislation increasingly takes an integrated view of financial groups. According to CRD IV,[20] the parent company

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14 http://ec.europa.eu/internal_market/consultations/docs/2012/companylaw/questionnaire_en.pdf.

15 Feedback Statement of 17 July 2012, pp. 12 et seq. (http://ec.europa.eu/internal_market/consultations/docs/2012/companylaw/feedback_statement_en.pdf).

16 Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies, 12 December 2012, COM(2012) 740 final on pp. 14 et seq. (http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0740&from=EN).

17 The second issue concerns the information on group structures. See also Informal Company Law Expert Group 2016.

18 For France, cf. Le Club des Juristes 2015. For Luxembourg, cf. Institut Luxembourgeois des Administrateurs 2015. For details, cf. Teichmann 2016. 150, 154 et seq.

19 Cf. Drygala 2013. 198; Hommelhoff 2013. 535; Teichmann 2013. 184.

20 Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, O.J. 27 June 2013 L 176/338.

is responsible for the organization and the management of the bank group, especially from the perspective of risk management. This also implies effective control of and influence on the subsidiaries. As far as banking resolution is concerned, the BRRD[21] provides for a group financial support agreement in the case of a rapidly deteriorating financial situation of one group member; the group company providing support may take into account the interest of the group if any direct or indirect benefits accrue to it (Art. 19 BRRD). This begs the question how prudential regulation and company law interact.[22] Even if such prudential regulation actually overrides any company law barriers to such actions, one may wonder whether such regulation is really bank specific or should be rolled out, at least to some extent, to general company law.

– Finally, under European law, the parent company may become liable for the actions of its subsidiaries. An outstanding example is the ECJ *Akzo Nobel* decision in competition law.[23] According to that decision, anti-competitive behaviour of a wholly-owned subsidiary can be imputed to the parent company as there is a presumption that the latter has made use of its influence over the conduct of the former. Therefore, subsidiary and parent company will incur joint and several liability for the payment of fines for infringements of competition law. Although the presumption is rebuttable, in practice it may be very difficult to show actual lack of influence in such situations. In any case, European company law is lacking instruments for the parent company to compel the subsidiary to abstain from anti-competitive behaviour.

However, by the end of 2014, the date set by the 2012 Action Plan, no initiative on group interest was announced; nor did this happen at a later stage. In particular, the proposal for a European single-member company (SUP), a special form of the national limited liability company, does not deal with the issue. The original Commission proposal[24] states in Art. 23 that the parent has the right to instruct this wholly-owned entity; however, that provision is qualified as the right only exists if there is no violation of national law, which of course runs counter to the goal of harmonizing different national provisions. Even this very limited provision has been deleted in the Council's General Approach.[25] Whatever the future fate of the SUP may be – and currently there is little reason to be over-optimistic as to its acceptance –, that legislative restraint is hard to justify in substance[26] as

21 Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms, O.J. 15 May 2014 L 173/90.

22 Cf. in this vein also Weber-Rey/Gissing 2014. 884.

23 C-97/08 P of 10 September 2009.

24 Commission Proposal for a Directive on single-member private limited liability companies COM(2014) 212 final.

25 Proposal for a Directive on single-member private limited liability companies – General Approach, Interninstutional File 2014/0120 (COD).

26 Politically, the reason may be that many Member States are reluctant to support the SUP project. Therefore, the Commission tries to minimize controversial issues.

the SUP would be the ideal company form to pursue business activities through subsidiaries in various Member States of the European Union.[27]

3. Response by Academia

Even if on a European level the momentum behind the recognition of the group interest is intermittent at most, on an academic level, the idea has found overwhelming support in recent years. In recent times, at least three different international groups have come forward with support for some kind of recognition:

– The European Model Company Act (EMCA) is a draft act, which is not a restatement of European company law, but a toolbox for legislators.[28] The Act recognizes the group interest as justification for the subsidiary's actions and broadly follows *Rozenblum* lines, but it includes the parent's rights to give instructions to the subsidiary. EMCA contains various measures designed to protect shareholders and creditors.

– In 2015, the Forum Europaeum on Company Groups published a proposal explicitly designed to facilitate the management of European cross-border groups.[29] The proposal aims at bringing the different interests of the group companies, including the parent, into equilibrium in the long term,[30] which also shows a clear tendency toward a more lenient, *Rozenblum*-inspired approach.[31] For so-called 'service companies', i.e. small or mid-sized, wholly-owned subsidiaries with purely auxiliary functions, the proposal is even more permissive: such companies must observe all directions by the parent company, unless they have the effect of precluding the company from fulfilling its obligations falling due within the year following the instruction.[32]

– Finally, the European Company Law Experts (ECLE), a group of international scholars in the field of company law,[33] has published observations on the reform of group law.[34] On a more general note than the two initiatives described above, the paper also takes a rather sympathetic position towards recognizing the group interest.

27 Cf. also Teichmann 2014. 3561, 3565.

28 Cf. http://law.au.dk/en/research/projects/european-model-company-act-emca/. At this stage, an official publication unfortunately is still outstanding; however, the text as it stands at this stage is easily accessible on the World Wide Web, e.g.: http://www.jura.uni-wuerzburg.de/fileadmin/02130100/EMCA_FINAL_DRAFT_2015_for_conference_rev.pdf.

29 Forum Europaeum on Company Groups 2015. 299.

30 Forum Europaeum on Company Groups 2015. 299, 303 et seq. (for 'ordinary' companies).

31 Teichmann 2016. 150, 156.

32 Cf. Forum Europaeum on Company Groups 2015. 299, 303 et seq.

33 See: https://europeancompanylawexperts.wordpress.com/.

34 European Company Law Experts 2016.

IV. Some Options and Decisions

But what will be the regulatory options if the European Commission decides, after all, to tackle the issue? This crucial question cannot be developed in detail here. A few remarks must be sufficient:

First, the Commission would have to decide on the type of instrument to be employed. As a regulation does not seem to be a viable alternative, two options remain. On the one hand, the Commission could try to harmonize national rules via a directive. This, of course, is the best option from the point of view of the business community, as it would encounter a common regime all over Europe – at least in the fields actually harmonized and assuming such a directive were not to contain any options for Member States. Having said this, politically, such an endeavour may easily become vain as the divergent approaches in the Member States in this field complicate the search for a compromise. From that point of view, issuing a recommendation would be the preferable route as the Commission does not need Member States' approval. Obviously, such a recommendation will not be binding on the Member States, but can only reach the aim of harmonizing national legislation if it develops enough persuasive force over time to overcome Member State resistance. Personally, I do not believe that this will happen easily in such a contested field. One suspects that the Commission's reluctance to tackle the issue may be partially based on this unappealing choice.

Second, and irrespective of the type of instrument, the Commission would have to identify the appropriate scope of application of such rules. At least three different issues come to mind:

– If it is the aim of the recognition of the group interest to facilitate the management of cross-border groups, then such an instrument could be restricted to situations in which parent company and subsidiary have their (real) seat in different Member States. However, this would lead to different legal regimes for the same national company types according to the nature of the shareholder – who may change with time. Additionally, even in cross-border groups, the subsidiary itself may be parent/holding company of a national sub-group. Any rule which curtails the relevance of the group interest to companies with the direct controlling shareholder in another Member State will probably not deal with such situations in an adequate manner; defining indirect control properly in legislative texts in order to encompass these situations is notoriously difficult. To my mind, it would seem preferable to introduce the relevance of the group interest both for cross-border and for national groups – which still leaves the thorny issue of defining the 'group' properly.

– Equally difficult is the question of the type of subsidiaries which should be included. The main issue is whether to include all or only wholly-owned subsidiaries. From a technical viewpoint, harmonization is much easier to

achieve if it is limited to wholly-owned subsidiaries as any protective measures will only have to take the interest of the creditors into account.[35] Once minority shareholders may become prejudiced, there is less justification for putting the interest of the group to the fore – which in practice more often than not will mean the interest of the parent company; additionally, with minority shareholders involved, it is much more important to measure the quid pro quo of intra-group transactions properly as these shareholders receive not only a fixed amount as (at least typically) creditors do, but are entitled to a share in the subsidiary's residual earnings. As a result, a liberal regime, which is of value to the parent company, is justified more easily with wholly-owned subsidiaries. As a side effect, a rule with a restricted scope may be easier to achieve politically as well as one of the most contentious issues is removed, i.e. the proper amount of and instruments for shareholder protection.

– Probably less crucially, the Commission would have to decide whether to include both private and public limited companies. A more narrow approach limited to private companies may be easier to achieve and will for practical purposes probably be sufficient as long as parent companies can change the type of company without undue burdens under national laws.

Third, the Commission would have to decide whether to propose such a rule as mandatory law or whether to enable companies to opt in via their articles of association; a company opt-out is also possible. From the point of view of signalling towards creditors (and shareholders), a flexible solution definitely seems preferable. In this way, companies may clearly indicate whether they are run exclusively in their own interest.

Fourth and on a more substantial level, the main issue is whether any European rule should just recognize the group interest and leave further specification to the Member States. This, of course, would make legislative success easier to achieve, but may limit the practical impact of such a rule as harmonization may only be achieved superficially if the crucial issues are left to the Members States, namely the type of and timeline for compensation. Conversely, the Commission could propose a fully-fledged test e.g. along Rozenblum principles, which certainly would be more valuable for the business community. An approach somewhere in between could combine a general statement with some type of white list of acceptable behaviour.

Fifth and finally, any such instrument would certainly result in the management of the subsidiary being able to avoid liability if it acts within the interest of the group as a whole. However, one could also imagine that the subsidiary's management in such cases is under a duty to follow instructions[36] – which would

35 Which probably limits the indispensable measures to balance sheet and/or solvency tests of some kind.

36 Supportive Hommelhoff 2014. 63, 64.

mean that a failure to do so would be a violation of duties, which in turn may lead to a liability. This, of course, would put additional pressure on management to be compliant. However, one may argue that even without such a duty the parent company will find ways to sanction non-compliance in other ways and that the threat of liability towards the parent company may foster excessively submissive behaviour.

V. Tentative Outlook

As described above, the Commission at this stage has not brought forward any initiatives to fulfil the promise given in the 2012 Action Plan (which, in any case, was not the work of the current Commission but of its predecessor). Is this likely to change?

Currently, there are two contradictory indicators. On the one hand, the Commission's academic advisory group for company law, the Informal Company Law Experts Group (ICLEG), has been working on a position paper on the issue for quite some time which has been published in 2017 and gives some indications as to the scholars' ideas on the issue. Informal Company Law Expert Group 2016.

On the other hand, the recent Commission Work Programme for 2017[37] does not mention any work on the group interest but announces company law initiatives to facilitate the use of digital technologies throughout a company's lifecycle and cross-border mergers and divisions. This certainly reveals the current Commission's short-term priorities. This does not necessarily mean that the Commission has renounced the aim of harmonizing the legal regime of the group interest. However, it is safe to assume that the next initiatives will not touch on the issue.

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37 Commission Work Programme 2017: Delivering a Europe that protects, empowers, and defends, COM(2016) 710 final on p. 8 (http://ec.europa.eu/atwork/pdf/cwp_2017_en.pdf).

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Policies and Doctrines in the Regulation of Air Passenger Rights

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Abstract. Air travel is not only a popular form of moving people for either business or leisure purposes but a risky activity that comes with so many complaints on the part of passengers. The aviation market is forced to face important consumer protection issues in Europe, and the European Union seems to be the first international organization to create unified liability rules for air carriers across the European Union and its Member States. The essay discusses the liability of air carriers and the interpretation and scope of defences listed in the Regulation, illustrating them with real cases in which national courts requested preliminary ruling from the European Court of Justice.

Keywords: strict liability, airlines, European Union, delay, cancellation, exoneration, compensation, Regulation (EC) No 261/2004, extraordinary circumstances

Aviation became a commonly accepted and popular form of travel and transportation during the 20th century. More and more people worldwide prefer flights over train or car travel. National legislative bodies realized early in the 20th century that operating aircrafts and conducting activities in the aviation business qualified as dangerous activities and risky business, so the aviation sector needed a set of safety and liability rules in order to guarantee the safety to passengers. There are multiple legislative products on the international level related to aviation, adopted by the majority of states of the world, just like the Warsaw and Montreal Conventions.[1]

1 Convention for the Unification of Certain Rules Relating to International Transportation by Air – Warsaw, October 12th, 1929 – and Convention for the Unification of Certain Rules for International Carriage by Air – Montreal, May 28th, 1999.

They unified the procedural and liability rules of carriers in case of accidents or if passengers' baggage were damaged or lost.

The events of 11 September 2001 in New York caused a big turmoil in the aviation sector, and the volume of air traffic decreased significantly as a consequence of the terrorist attacks carried out that day. It took a couple of years until everything got back to normal, and the intensity of air travel even superseded its past results.[2] Nowadays, aviation is one of the busiest and safest ways to travel.

However, aviation is not only a risky activity but also a sector of economy where carriers have to deal with passengers and satisfy their needs. This activity may come with many complaints coming on the part of passengers. On the other hand, carriers continuously compete with each other in order to convince millions of passengers to choose their services over the competition. In this heavy competition, passengers are left defenceless and may suffer harms caused by the carriers in the form of breaching the travel contracts.

At the beginning of the 21st century, the aviation market has to face important consumer protection issues in Europe, and thus a new regulatory approach has emerged in the continent. This new phenomenon is the recognition of passenger rights. States should provide more powerful rights to passengers and protect their interests against the carriers.

The European Union was the first international organization to establish unified liability rules[3] mandatory to air carriers across the European Union and enact new rules for the undesirable events of cancellation, delay, and overbooking. As a result of the new regime, passengers now have efficient and powerful rights when the carrier breaches the contract and fails to fulfil its obligations.

However, in case a flight is delayed or cancelled under the scope of the 261/2004/EC Regulation, it does not automatically mean that the carrier must pay a compensation. The airline is obliged to do so only if the passengers reach their destination at least 3 hours later than originally scheduled,[4] and there are no any extraordinary circumstances that could lead to the exoneration of the carrier.

This essay focuses on the policies that formed the valid rules in Europe and influenced the interpretation of the European Court of Justice. In order to do so, it is necessary to examine in which cases the carriers are able to successfully

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2 http://www.icao.int/sustainability/Pages/Facts-Figures_WorldEconomyData.aspx.

3 Council Regulation (EEC) No 295/91 of 4 February 1991 establishing common rules for a denied-boarding compensation system in scheduled air transport; Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, and repealing Regulation (EEC) No 295/91.

4 Court of Justice, judgment of 19 November 2009, case C-402/07, Christopher Sturgeon and Stefan Böck.

exonerate themselves under the strict liability rules based on the recent case-law and interpretation of the European Court of Justice.

Policies behind the Defences

An operating air carrier shall not be obliged to pay compensation in accordance with the Regulation if it can prove that the cancellation is caused by extraordinary circumstances, which could not have been avoided even if all reasonable measures had been taken.[5] Such circumstances may, in particular, occur in cases of political instability, meteorological conditions incompatible with the operation of the flight concerned, security risks, unexpected flight safety shortcomings, and strikes that affect the operation of an operating air carrier. Extraordinary circumstances should be deemed to exist where the impact of an air traffic management decision in relation to a particular aircraft on a particular day gives rise to a long delay, an overnight delay, or the cancellation of one or more flights by that aircraft, even though all reasonable measures had been taken by the air carrier concerned to avoid the delays or cancellations.

Defences under liability of air carriers still remain an uncertain and most crucial topic when it comes to the interpretation of the Regulation. Although the Regulation does not directly and explicitly list the potential defences in its text, its preamble gives some possible circumstances listed above. The ECJ carried the interpretation of these defences far in some aspects, while leaving doubtful questions and uncertainties in others.

The first question we should try to answer is why the ECJ interprets the Regulation in that way. We could assume that there must be some policy behind this concept.

At first sight, the lobbying activity and influence of various carriers may be one of the reasons. By examining the liability rules of all carriers in the European Union, there is an important fact we have to pay attention to. Bus and water carriers are in a better position than railway and air carriers. They can seek for exoneration much easier than carriers in the aviation and rail business. For example, according to the findings in the McDonagh case,[6] airlines have to cover the costs of accommodation and take sufficient and reasonable care of passengers when extraordinary circumstances – such as a volcanic eruption – leads to the cancellation of a flight. When bus and water carriers have to face a force majeure situation, they are not obliged to cover the costs of accommodation for passengers.

5 Art. 5, para. 3 Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights.

6 Court of Justice, judgment of 31 January 2013, case C-12/11, Denise McDonagh.

The other significant difference is that the amount of compensation is much higher when air carriers breach the travel contract. Carriers in other sectors have an obligation only to pay back a fix percentage – no more than 50% –[7] of the cost of the fare, taking into consideration the length of the delay. Airlines, however, have to compensate passengers with €250, €400, or €600, depending on the length of the flight.[8] It seems that the airlines have the weakest influence and lobby power in vindicating rights, while other carriers could certainly achieve better positions. There is a significant difference in the status of the carriers not only because the European Union's legislative bodies have enacted such rules but because of the even more rigid interpretation of the European Court of Justice.

The second question is why the European Court of Justice interprets the rules of the Regulation (EC) 261/2004 in such a way to establish an even stricter liability of the airlines. It is not a question that the Regulation has originally introduced a strict liability of the air carriers for the events of delay, cancellation, and denied boarding. Although there is no such thing as a unified European tort law and there are no principles that could govern the adjudication of compensation, national courts still have to deal with these questions, theoretically, in a somewhat unified way. National courts can, however, rely on the case-law and interpretation of the ECJ, as the ECJ is the only judicial body that has a right to authentically interpret the primary and secondary law of the European Union. Based on our experiences, the ECJ often uses the methods of grammatical and teleological interpretation. The purpose of Regulation (EC) 261/2004 aims to give more power to passengers and to protect their interests against the cost-efficient policy of the airlines. The Court is definitely widening the scope of the Regulation by emphasizing the consumer protection approach.

In the analysis of the case-law of the ECJ, we can also notice that there should be a contract between the airline and the passenger. It means that, theoretically, we are facing with a breach of contract situation when a delay or a cancellation occurs. Although the Vienna Convention on International Sale of Goods (CISG) is not applicable, we may still identify certain similarities when an airline tries to seek for defences in order to exonerate itself under the burden of strict liability. According to the CISG, a fundamental breach occurs when one party substantially fails to deliver what the other reasonably anticipated receiving. In order for the

7 Art. 17 Regulation (EC) No 1371/2007 of the European Parliament and of the Council of 23 October 2007 on rail passengers' rights and obligations; Art. 19 Regulation (EU) No 1177/2010 of the European Parliament and of the Council of 24 November 2010 concerning the rights of passengers when travelling by sea and inland waterway and amending Regulation (EC) No 2006/2004; Art. 19, para. 2 Regulation (EU) No 181/2011 of the European Parliament and of the Council of 16 February 2011 concerning the rights of passengers in bus and coach transport and amending Regulation (EC) No 2006/2004.

8 Art. 7, para 1 Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights.

breaching party to exonerate himself, he should prove that his failure was due to an impediment beyond his control, the impediment was not something he could have reasonably taken into account at the time of contracting, and he remains unable to overcome the impediment or its consequences. The breaching party should prove these circumstances at the same time, as these conditions are meant to be interdependent conditions. In the aviation business, it is quite easy to prove the second requirement, namely that the airline could not foresee a circumstance that impedes it in fulfilling the contractual obligations. The remaining two conditions, however, seem to be more problematic; still, we can see that the ECJ applies these rules with analogy based on the case-law attached to the application of the CISG. We believe that it is quite obvious that if the European Parliament and the Council adopt a law in order to establish new rules for a sector as the aviation sector, the ECJ needs to look elsewhere to fill the gaps the Regulation has left. The CISG seems to be a sufficient choice as we are facing a contractual problem in both cases. According to the 261/2004/EC Regulation, the liability of the airlines shall be strict liability. The case-law attached to the application of the CISG is quite developed by now, so it may really help the ECJ in interpreting the rules of the Regulation. In order to understand the exact cases when the airlines are not held liable for breaching the contract, we should examine the case-law of the ECJ related to the interpretation of the Regulation.

According to the Sturgeon decision ruled in 2009, the ECJ found that passengers might also be entitled for compensation not only in case of cancellation and denied boarding but in case the flight is delayed three or more hours.[9]

First of all, we have to clarify what the relevant time is under the term ‘time of arrival’. We may list four different circumstances that can easily qualify as ‘time of arrival’. These events are the following:

– the time the aircraft lands on the runway (‘touchdown’);

– the time the aircraft reaches its parking position and the parking brakes are engaged or the chocks have been applied (‘in-block time’);

– the time the aircraft door is opened;

– a time defined by the parties in the context of party autonomy.

There could be slight differences in these referred moments, and these several-minute differences should decide whether the air carrier has breached the contract, and therefore is obliged to pay compensation to the passengers. In the Germanwings GmbH versus Ronny Henning case,[10] the European Court of Justice had an opportunity to examine this problem and to interpret the underlying provisions in the Regulation. According to the ECJ’s ruling, the time that the aircraft door is opened should be

9 Court of Justice, judgment of 19 November 2009, case C-402/07, Christopher Sturgeon and Stefan Böck.

10 Court of Justice, judgment of 4 September 2014, case C-452/13, Ronny Henning.

relevant in such cases as passengers may feel the end of the journey at that time. This is when the physical opportunity to leave the plane opens to all passengers.

After the question of breach has been decided, the airline can seek for defences and state that one of the following extraordinary circumstances was the underlying cause of the delay or the cancellation: political instability, meteorological conditions incompatible with the operation of the flight concerned, security risks, unexpected flight safety shortcomings, strikes that affect the operation of an operating air carrier, and air traffic management decisions. All of these situations seem to offer easy defences under the strict liability; however, they are more complicated than they seem. At least, this is what the recent case-law of the European Court of Justice proves.

Unexpected Flight Safety Shortcomings

Before we interpret unexpected flight safety shortcomings as easy defences for the air carrier, we must state that all safety issues must fall outside the control of the airline in order to provide successful exoneration under the duties as stipulated by the Regulation. This is the reason why the ECJ can only accept safety shortcomings as defences with many restrictions.

In order to get the true meaning of unexpected flight safety shortcomings, we have to analyse two cases: the Wallentin-Hermann[11] case and the Siewert[12] case. In the first case, Alitalia airline had some trouble with the plane's engines and the flight was delayed 24 hours. In the second case, the flight was performed with a six-and-a-half-hour-long delay that occurred because the aircraft that was due to operate the flight concerned suffered some damage at Stuttgart Airport the evening before. A set of mobile boarding stairs had bumped against the aircraft, causing structural damage to the wing, and, as a consequence, the aircraft needed to be replaced. The two most important questions the court had to examine was whether the airline could not, on any view, have avoided the extraordinary circumstances by measures appropriate to the situation – that is to say, by measures which, at the time those extraordinary circumstances arise, meet, inter alia, conditions which are technically and economically viable for the air carrier concerned,[13] and the circumstances surrounding such an event can be characterized as 'extraordinary' within the meaning of the Regulation only if they relate to an event which is not inherent in the normal exercise of the activity of the air carrier concerned and is beyond the actual control of that carrier on account of its nature or origin.[14]

11 Court of Justice, judgment of 22 December 2008, case C-549/07, Wallentin-Hermann.

12 Court of Justice, judgment of 14 November 2014, case C-394/14, Sandy Siewert.

13 Court of Justice, judgment of 12 May 2011, case C-294/10, Eglītis and Ratnieks, para. 25.

14 Court of Justice, judgment of 22 December 2008, case C-549/07, Wallentin-Hermann, para. 23.

The reason of this strict and narrow interpretation of the Regulation is the fact that consumers need a high level of consumer protection in the EU.[15,16]

There are only three unexpected safety shortcoming cases which can qualify as circumstances outside the interest of the carrier. Manufacturing defect is one of those cases, when the airline has no influence on the risk. The other two cases are terrorist attacks or sabotage. In the two latter cases, terrorists or saboteurs are responsible for the mechanical failures of the plane. Anything else other than the three cases mentioned above could be prevented with exercising the necessary maintenance duties.[17]

Meteorological Conditions Incompatible with the Operation of the Flight Concerned

Weather is always an uncertain factor in the aviation business. In most countries of the world, bad weather will not constitute liability for the air carriers since weather is a typical example of force majeure. It is true that the air carriers do not have influence on this extraordinary circumstance. Although science and technology are well-developed and high-standard these days, it is a generally accepted fact that airplanes cannot take off in a snowstorm, T-storm, or in thick fog.[18]

Seeking for the interpretation of meteorological conditions incompatible with the operation of the flight concerned, we would like to demonstrate the Denies McDonagh[19] case. Volcano Eyjafjallajökull in Iceland started to erupt on 20 March 2010. On 15 April, right after the volcano had entered an explosive phase, the authorities shut down the airspace over a number of Member States due to potential risk and hazard to aircrafts, and grounded many planes for almost a week. Some airlines interpreted the rules of the regulation as an absolute, unconditional reason to exonerate under strict liability. They thought they were not obliged to provide any services or compensation to their customers at all. Even the necessary care (food, accommodation, communication, etc.) does not seem relevant.

Ms McDonagh booked a flight with Ryanair that was scheduled to depart on 17 April 2010. The airfare costed €98. Her flight was cancelled due to the eruption. During the period between 17 and 24 April, Ryanair did not provide Ms McDonagh

15 Court of Justice, judgment of 10 January 2006, case C-344/04, IATA and ELFAA, articles 43–47.

16 These authors criticize the C-549/07. Friederike Wallentin-Hermann v Alitalia – Linee Aeree Italiane SpA case and the rules of the Regulation: Arnold. de Leon 2010, 91-112, Balfour 2009, 224–231, Croon 2011. 1–6, 2012. 609–617.

17 Court of Justice, judgment of 22 December 2008, case C-549/07, Wallentin-Hermann.

18 Arnold, K. 2007. 105.

19 Court of Justice, judgment of 31 January 2013, case C-12/11, Denies McDonagh.

any care as it was laid down in details in the Regulation.[20] The question was whether a meteorological condition like a volcano eruption can qualify as *vis maior*, in which case airlines do not have to pay compensation and provide sufficient and reasonable care to their passengers. The plaintiff claimed €1,129 to cover her meal, accommodation, and transportation during that period. The ECJ did not argue that a volcanic eruption was a force majeure, however, the ECJ ruled for the plaintiff. The Court emphasized that the duty to provide passengers with reasonable care in the undesired events of delay or cancellation are imperative rules ordering an absolute obligation for the airlines, and they cannot be neglected on the sole reason that a force majeure arose. Providing meals, accommodation, and transportation to passengers is an absolute obligation of the air carriers, and therefore they do not have proper defences that could lead to their exoneration, according to the interpretation of the ECJ. Regarding the amount spent on these expenses, the Court examined whether the given care was adequate and reasonable. The evaluation of the exact amount belongs to the jurisdiction of national courts, according to the ECJ.

Security Risks

Security risks are not defined in the regulation and no ECJ case-law exists in this field. If boarding is completed and doors are closed although the final check before take-off reveals extra bags on the plane travelling without passengers, this may qualify as a security risk that prevents the airline to operate the flight according to schedule. Another typical security risk may be when more passengers boarded the plane that it is shown on the check-in list. In these cases, it is not relevant whether this situation is a result of the airline's negligence or the intentional conduct of passengers since these security risks must be clarified before take-off in order to provide safe service to customers. Especially after 9/11, the European Union and air carriers value security measures a lot more than before.

Worker Strikes

In the case of either a lawful or wrongful strike of employees, the air carrier is exempted from liability.[21] The reason why there is no difference between a lawful and a wrongful strike is that both are outside the influence of the employer, the air carrier. Even if the airline later gets a decision from the national court to

20 Art. 9, Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights.

21 ILO judgment No 368.

evaluate the strike as an unlawful one, the employer had no reasons to believe so and, more importantly, had no lawful instruments to intervene without a binding court decision. However, the European Court of Justice drew attention to the fact that the carrier's exemption is only valid for the passengers of the actual flight concerned in the strike. All other flights must operate according to schedule and the carrier cannot extend this defence generally to more flights.[22]

Air Traffic Management Decision

According to the Preamble, the extraordinary circumstances should be deemed to exist where the impact of an air traffic management decision in relation to a particular aircraft on a particular day gives rise to a long delay, an overnight delay, or the cancellation of one or more flights by that aircraft, even though all reasonable measures had been taken by the air carrier concerned to avoid the delays or cancellations.

However, the air carriers cannot rely on extraordinary circumstances as general defences that lead to their exoneration. The moment the extraordinary obstacle diminishes, the airline has to continue the service as planned. In one case, passengers have already boarded the plane, waiting for take-off, when a sudden black-out intervened. When the power had come back, the plane still could not take-off, and the airline cancelled the flight. Later, passengers learned that the real reason of cancellation was not the black-out, which is an extraordinary circumstance, but that the flight attendants' time shift expired. The European Court of Justice ruled for the passengers claiming damages for the cancellation. The court stated that an air carrier must plan ahead and think of such extraordinary measures that differ from force majeures. Since these extraordinary circumstance may happen at any time, the carrier must plan accordingly and take reasonable care in order to minimize their consequences. This is why all flight schedules are planned with some gaps. If the airline does not fulfil this obligation, he cannot successfully refer to the defence of extraordinary circumstances.

Political Instability

Political instability does not have a commonly accepted definition neither in the text of the regulation nor in the practice of the European Court of Justice since no case has ever reached the ECJ to scrutinize this problem. In order to get closer to the definition of political instability, we should take into consideration constitutional and public international law institutions as well. According to

22 Court of Justice, judgment of 4 October 2012, case C-22/11, Timy Lassooy.

these, political instability is the governing of a country without a stable and well-functioning government. In this case, an opposition party or militia aspire to the acquisition or alteration of the governing political power. Such circumstances may be military operations, military coups, civil wars, revolutions, or rebellions.

Although political instability seems to be an objective defence for the air carriers, still, in every case, we must examine whether the air carrier could have avoided the influence of such circumstances by taking necessary and reasonable measures and care. Another criterion for a successful exoneration under the strict liability rules is that political instability should qualify as force majeure, independent of the influence of the air carrier.

In one case, a British Airways flight was forced to stay on the ground due to the activity of military groups in Kuwait.[23] The English court had to decide whether this situation is qualified as one outside the air carrier's scope of influence.[24] The court applied the rules of the Montreal Convention[25] in this case. The trial judge came to the conclusion that military group activities did not belong to the influence of the air carrier, so it could not have been foreseeable and avoidable even if the air carrier had been aware that military operations were going on in the country. This interpretation might be applicable in cases under the scope of the EU regulation.

Closing Remarks

After having examined the nature of the regulation on air passenger rights, we can safely conclude that the problem is not only the strict liability imposed against air carriers and other transportation service providers but the interpretation and application of such rules by the European Court of Justice. A rigorous approach on the defences available to air carriers may easily change the structure of competition in the European aviation market. It may have a significant impact on not only the fares but on the mentality of the passengers too. We may already experience a change in the passengers' attitude. More and more disputes are raised against airlines based on claims about insufficient services. In these disputes, national courts are obliged to follow the interpretation of the ECJ as the Regulation requires a uniform application across the entire European Union.

The strict rules on passenger rights in the European market may also induce a change in the U.S. and in Asia, and the competitiveness of American, Asian, and European airlines may also suffer consequences induced by this improving

23 Panalpina International Transport v Densil Underwear Ltd [1981] 1 Lloyd's Rep 187.
24 Jones 1996 134–135.
25 Convention for the Unification of Certain Rules for International Carriage by Air – Montreal, May 28th, 1999.

concept on passenger rights in Europe. The revision of the Regulation on air passenger rights is ongoing in the European Union. However, we believe that any restriction on the rights granted to air passengers would be a significant step back from the current situation, and it could lead to a long adoption and implementation process.

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