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## **New in the Czech Civil Code - rules for family Enterprise**

MAREK, KAREL and JANKU, MARTIN

VSFS, a.s. Praha, VSFS, a.s. Praha

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# NEW IN THE CZECH CIVIL CODE – RULES ON FAMILY ENTERPRISE

Karel Marek, Martin Janků

## Novinka v českém občanském zákoníku - pravidla pro rodinné podnikání

### Abstract

For more than two decades the family business enterprises of the first generation (generation of founders) are more and more dominating in the category of today's Small and Medium-sized Enterprises in the Czech Republic. The necessary legal background defining the legal relationships and rights of all participating persons was, however, limited to general provisions in the Commercial Code that hasn't solved many of the problems associated thereto. Only in 2012 the new Czech Civil Code, Act. No 89/2012 Coll., introduced the institute of family enterprise as completely new term in the Czech Civil law. The present paper aims to analyse the key rules of this new legal regulation, focusing on significant aspects of the institute in the context of commercial law and family law, as well as to highlight the potential weaknesses in the regulation itself.

**Key words:** family enterprise – family member – involvement in the operation of family enterprise – profit share and property gains

### Abstrakt

Již více než dvě desetiletí dominují v kategorii malých a středních podniků v ČR rodinné podniky první generace (generace zakladatelů). Nezbytná právní regulace vymezující právní vztahy všech zúčastněných osob se však dříve omezila na obecná ustanovení obchodního zákoníku, která neřešila specifické problémy. V roce 2012 vstoupil v platnost nový občanský zákoník, tj. zák. č.89/2012 Sb. Ten upravil institut rodinného podniku jako zcela nový institut v českém právu. Tento příspěvek si klade za cíl analyzovat klíčová pravidla této nové právní úpravy, se zaměřením na významné instituty v kontextu obchodních vztahů a rodinného práva a také upozornit na potenciální slabiny této nové právní úpravy.

**Klíčová slova:** rodinný podnik – rodinný příslušník – zapojení do činnosti rodinného podniku – podíl na zisku a majetkové vztahy

## 1. INTRODUCTION

After the democratisation of the society and privatisation of the national economy in Czechoslovakia after 1989 (since 1993 Czech Republic and Slovak Republic) only gradually small enterprises that appeared and started to operate were stabilised in the economic and legal form of family business enterprises. The necessary legal background defining the legal relationships and rights of all participating persons – relatives and other family members - however, lagged behind, and was limited to general provisions in the Commercial Code that hasn't solved many of the problems associated thereto. Only in 2012 introduced the new Czech Civil Code, published as the Act. No 89/2012 Coll., the institute of family enterprise as completely new term in the Czech Civil law.

## 2. GOAL OF THE PAPER

The regulation of the family enterprise has no tradition in the Czech law. Thus, it's a completely new institute the roots of which we may find in the Italian *Codice Civile* (Art. 230bis)<sup>1</sup>. According to Explanatory Memorandum to the Civil Code the rules are aimed at filling the gap in regulation where the family members are in fact working for a family enterprise without their rights and obligations would be governed by a special contract closed to that purpose. It is true that also in the Czech business environment we could often encounter such regulation because the family business is a frequently employed arrangement of commercial relationships, where family members work under the guidance of one family member. Agricultural farms, family hotels or restaurants may serve as an example. Before the 2012 Civil Code there were no contractual rules for these arrangements. Such relationships were often solved by the use of rules on unjustified enrichment. However, this caused unequal relationships not only as regards the shares of family members on the profit obtained but also situations where some of the family members had either decision-making powers and responsibilities, nor could they claim settlement shares at the time of termination of their participation in the family business. Working for a family business without having a labour contract was even held for illegal work and there were considerations about tax evasion and avoidance of health and social insurance.

The rules of sections 700 to 707 Civil Code prevent the presence of such irregularities in the future. However in the process of application of the new rules we face some interpretation problems and gaps that the present paper will analyse. We encounter the interpretation problems already in connection with the definition of the term family enterprise. In interpreting the statutory rules we should also take in consideration the circumstance that before the legal rules commercial practices and customs established in the family enterprise take precedence provided that they are not contrary to the legislation in force, i.e. provisions of Sections 700 to 706 Civil Code. These commercial practices and customs may serve also as interpretation tools for the determination of rights and obligation of the participating family members.

As follows from the above stated, the aims of the regulation of family enterprise to rule the position of those family members who – without any legal grounds - take part in the business of an enterprise owned by some of the family members and thus to provide legal basis to the claims for their personal contributions. Ruling this aspects, however, brought a significant limitation of ownership rights of the family business owner and, given the rather vague definition of cases to that these limitations apply, we may expect disputes on the interpretation of these cases and scope of the limitations.

The adoption of the new legislation brought a significant limitation of rights of the family business owner and due to the somewhat vague identification of cases to that such restrictions apply, we may expect disputes concerning the interpretation of these cases and the extent of the restrictions and await the resulting case law. The fact is that the owners of existing family enterprises were not prepared for the limitation of their ownership rights that occurred when the Civil Code entered into force. When interpreting these rules we must, further on, realize that the family community, to which the new legislation applies, may have in fact exist for many years before and to the effective date of the Civil Code haven't to meet any formal requirements to fall under the application thereof. Therefore they did not have to sign any contracts, or make arrangements in order to be subjected to the new legislation. If, in the context of family communities, their relationships satisfy the conditions of the family enterprise, the legislation in question applies automatically to them.

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<sup>1</sup> Italian regulation is effective for almost 40 years, since the rules on the family enterprise were establishes along with the reform of the Italian family law in 1975, when, inter alia, the institute of L'Impresa Familiare was introduced.(see TARDIVO, G., CUGNO, M., 2011)

The paper aims at analysing of selected issues of the new legal regulation, focusing on significant aspects of the institute in the context of commercial law and family law, as well as to highlight the potential weaknesses in the regulation itself. The text was prepared on the basis of general theoretical scientific methods. The use of analytic method is accompanied by the historical method when comparing the rules contained in the former Commercial Code. Comparative method is employed also in the highlighting of the origin of the new institute and its relatively recent formation.

Paper opens with characteristic features of the notion of family enterprise itself. After that is defines the family members who are legally entitled to be involved in the operation of a family enterprise. Leading role belongs logically to the owner of the family enterprise and thus the subsequent part characterises its specific position among the family members including the ownership of the enterprise. After a brief characteristic of the formation of a family enterprise the following part focuses on claims that belong to family members involved in the operation of the enterprise. Explanations on the transfer of participation in family enterprise are followed by the regulation of possibilities for termination of participation by family member and - finally – of the dissolution of the family enterprise as a whole.

### 3. RESULTS AND DISCUSSION

#### 3.1. The notion of family enterprise

The family enterprise is most often defined as a kind of commercial enterprise (Section 502 Civil Code) in which spouses and persons within a defined family relationship with at least one of the spouses work together.

It is doubtful whether the definition of family enterprise as a type of the commercial enterprise (Section 502 Civil Code) without further specification as this means its definition merely as a sort of „collective asset“ (*universitas rerum*). This specification doesn't respect that the basis of the legal regulation of family enterprises is the ruling for rights and obligations of participating family members when operating the commercial enterprise. For the definition of the latter it is therefore necessary to stress the personal component as the particular issue of the regulation. Undisputedly, there is no family enterprise without the specification and operation of a commercial enterprise under Section 502 Civil Code and it can be said that the focal point for the setting up of a family enterprise is establishing and operating of the commercial enterprise. A commercial enterprise, however, is defined as organised set of business assets, whereas the basis of a family enterprise is the ruling of contract-free relationships between family members in the course of operation of a set of business assets. Therefore we hold that a more precise definition of the family enterprise is a specification emphasising the personal component and defining a family enterprise as family community that is established for the purpose of running a commercial enterprise. For the definition of the family enterprise is not a crucial issue the proprietary essence of the commercial enterprise that forms the basis of the family enterprise, but it is namely the personal participation of defining family members therein.<sup>2</sup>

It is irrelevant what is the subject of business of the commercial enterprise, which are its property components or what is the value of the set of assets forming the enterprise. However, it is of relevance which persons are involved, on a permanent basis, in the operation of the enterprise, and if these are persons as defined by the legal provisions, then it is a family enterprise - provided there is no contract between these persons or any other reason that would make applicable a different legal institute for the regulation of their relationships. We thus conclude that the relationships between family members involved in the operation

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<sup>2</sup> For economic aspects of the family enterprise, see i.a. Petlina, L., Koráb, V., 2015

of the family enterprise are not personal component of this enterprise of that kind we may specify the latter in the case of any commercial enterprise. In the case of disposal with the family enterprise, his demise and/or the loss of the enterprise nature as a family enterprise will occur, without personal relations being transferred to the purchaser of the enterprise. Therefore we consider the family community in the sense as defined above should be regarded in that way that is not part of the commercial enterprise as its component and these relationships are placed outside the organized set of all components that make up the enterprise.

As characteristics of the family enterprise we may indicate:

- a) Existence of the commercial enterprise
- b) Operation of the business
- c) Personal involvement of the family members in the operation of enterprise or keeping of a household, whereas the persons shall be relative in a degree defined by the law
- d) permanent nature of the involvement
- e) personal involvement in the operation is not covered by a contract

A question may be raised whether the joint labour of the spouses or at least one of them together with relatives in the statutory defined degree (see sub c) above) should not be a separate characteristic of the enterprise..

If the above characteristics are met, we can talking about the family enterprise

### 3.2 Family members involved in the operation of family enterprise "

Family members who may be involved in the operation of the family enterprise, are defined by the legislation as spouses, or at least one of the spouses and their relatives up to the third degree, or persons relative in the brother-in-law degree with the spouses to the second degree. According to this wording of the Civil Code we may conclude that the basis for the family enterprise is a married couple, or at least one of the couple. A question arises whether for the establishment of the family enterprise the existence of a married couple is a precondition – at least at the moment of its very establishment – and whether the degree of relativity or brother-in-law relationship devolves from the couple or at least one of them. We can held that there is no justification for such a conclusion and we can't interpret the family enterprise in such a narrow way. According to our opinion the family enterprise can thus be established even in cases where none of the family members is in the marital relationship, provided the members meet the condition of being related up to the third degree or in a brother-in-law relationship up to the second degree (KUČERA, J., 2015). The narrow interpretation would not meet the purpose of the new legislation as specified in the Explanatory Memorandum to the Civil Code.

In order to specify of the personal component of the family enterprise, it is necessary to determine also the notion of relatives and brothers-in-law of the spouses, as we have to deal exclusively with persons that may be involved as family members in the operation of an family enterprise and enjoy rights and obligations defined by the Civil Code. In specifying the sequence of relatives up to the third degree we shall apply the provision of Section 773 Civil Code that says that the degree of relationship between two people is determined by the number of birth, which comes in direct line from one another and in the next two lines from their nearest common ancestor. Therefore, we have to distinguish between relative in first degree, namely parents and their children, in the second degree grandparents and their grandchildren, and in the third degree the great-grandparents and their great-grandchildren. Further on, we may involve the side line, i.e. whether the related persons have a common ancestor and do not come from one another. In this case, the first degree is out of question of and the second degree relatives are siblings and the third degree relatives are uncle and nephew and aunt and niece

As regards the persons related on the brother-in law line, the Section 774 Civil Code applies. The affinity arises through marriage between one husband and relatives of the other spouse, in which line and to what degree is related to someone with one husband, in a line in which the degree is in brother-in-law relation with the second husband. Therefore, essential for the definition of family enterprise is the fact that after the termination of the marriage due to the death of one of the spouses or his/hers declaration for dead the brother-in-law relationship shall not cease]. The brother-in-law relationship is of relevance for the definition of the family enterprise up to the second degree. This means that a spouse shall be due to the marriage in brother-in-law relation of first degree with parents of the other spouse, his/her children, great-parents and grandsons or siblings of the spouse.

The legal rules require that the relatives or brothers-in-law are involved in the operation of the family enterprise in person or that they work for the family on a permanent basis [9], whereas no difference is made between these two categories except for the performed type of the work; all persons are held for family members involved in the operation of the family enterprise<sup>3</sup>.

It is also necessary to answer the question who represents the person in relation to that we shall determine the relativity or brother- in-law relation. The only logical person is the owner of the business enterprise, at least at the time of the establishment of the family enterprise. The Civil Code indicates the spouses or at least one of them who work in person in the enterprise. We may also encounter a broad definition of the institute of family enterprise where - in the case of existing family enterprise - every family member connection to any member of the family who is involved in the operation of the enterprise is admitted. In other words, the delegation of the involvement is possible to a person, which is the way laid down by the Section 700(1) Civil Code linked to any member of the family (ŠVESTKA,J., DVOŘÁK.,J., FIALA J., ZUKLÍNOVÁ, M. e. a., 2014, sv.II). For this interpretation the link of a family member to the owner of the enterprise is not considered and the owner may influence the non-delegation of the involvement only by his/her disapproval

It is convenient to deal also with the question how many family members at least must be involved in the operation of the family enterprise to that the characteristics of the family enterprise shall be met. However, in the doctrine and/or the existing case law we will find no reference to answer that question. So we may conclude that two family member are enough to form a family enterprise and none of them have to be in marital relationship<sup>4</sup>.

### 3.3 Owner of family enterprise

The answer to the question who can be the owner of a family enterprise, gives us Section 700(1) Civil Code in the first sentence. According to this provision we can conclude that business enterprise that is considered for a family enterprise, must be owned by one or more individuals (ŠVESTKA,J., DVOŘÁK.,J., FIALA J., ZKUKLÍNOVÁ, M. e. a., 2014, sv.II). Due to the linguistic interpretation of this provision we may deduce that no legal (moral) person is admitted as the owner. But in practice we find cases where the enterprise of a legal person is operated in the way meeting all criteria for its specification as family enterprise and the application of the rules for family enterprises would be suitable as they would meet the purpose and aim of the latter. As a typical example we may quote single-person limited liability companies where relatives or brothers-in-law of the shareholder of the company are

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<sup>3</sup> See the Explanatory Memorandum to the Act No. 89/2012 Coll. /Civil Code/:"Also the the family member who is permanently working for the family, in particular, takes care of the family household is put on the same level with the family members who perform labour for the family enterprise. It is the consistent fulfillment of the statutory principle that the personal care of the family and its members is of the same importance as the provision of proprietary performance. "

<sup>4</sup> With respect to the priority of the matrimonial property law we may conclude that the family enterprise can't be establish only between the spouses, not even in the case of their separated property

together involved in its operation. We believe that in such cases there is no serious reason for non-application of the rules for family enterprises. This conclusion can be supported also by the second paragraph of Section 700 Civil Code that excludes the establishment of a family enterprise in cases where the rights and obligations of family members involved in the operation of the enterprise are ruled by articles of association including the founding legal act establishing a commercial company or cooperative agreement. There are thus explicitly excluded forms when community of family members exists within a commercial company but not cases when one of the family members stands as partner (shareholder) in legal person that operates a commercial enterprise and other family members are involved in a form that is not covered by a contract.

Given that the owner of a commercial enterprise can be – under the current legislation - a private non-entrepreneurial person, even a minor, we hold that identical conclusion can be made as regards the ownership of family enterprise. With respect to the fact whether the owner must be personally involved in the operation of the enterprise we can conclude that for the latter it is not the case. Also the management of the undertaking can be procured by other person than by the owner.

With respect to the circumstance that the new legislation admits that one and the same person may be the owner of more enterprises, we can't preclude the alternative that the nature of the family enterprise shall have only one of them, namely the one in the operation thereof are the family members really involved in person.

#### 3.4 Ownership form of family enterprise

There can be no doubt that a commercial enterprise in the operation of which are involved family members may be in single ownership or co-ownership by shares. It is, nevertheless, questionable whether commercial enterprise can be in the joint ownership of spouses. We would answer the question positively. Excluded is, however, application of family enterprise statute to situations when all family members involved in the operation of the enterprise will be at the same time co-owners of shares in the enterprise. The legislation of the ownership right must take precedence.

#### 3.5 Formation of family enterprise

The legislation doesn't rule in details the conditions for the formation of family enterprise. Since the existence of a commercial enterprise brought to operation is necessary for the existence of the family enterprise, we may conclude that a family enterprise can be formed not sooner than at the moment of the formation of the commercial enterprise and/or start of its operation. No formal prerequisites are necessary for the formation of a family enterprise and the fact that we have to do with this type of commercial enterprise doesn't need to be recorded in the public register. We may held that no third person must be aware of the fact that a commercial enterprise is run in the form on the family enterprise. We can thus characterise the formation of the family enterprise as being established by *de facto* involvement in person of relatives or brothers-in-law of the owner of the enterprise. It is obvious that the family enterprise is base on a fiction (ŠVESTKA,J., DVOŘÁK.,J., FIALA J., ZUKLÍNOVÁ, M. e. a., 2014, sv.II).

The family enterprise may be also formed at any time in the course of operation of an commercial enterprise.

The family enterprise shall not be formed by leasing of an enterprise, as a precondition for the formation of family enterprise is its ownership by a family member.

The family enterprise is based on the fact that the claims of the family members are not covered by a contract. It remains a question whether it is according to the law to rule on some questions by mutual agreement of all involved family members.

If some family communities that suit the conditions of the family enterprise under the 2012 Civil Code have been active before January 1, 2014 and continued after the record day we

may held that the family enterprise has been formed to that day and since this time the relevant rules on family enterprise of the new Civil Code shall apply. In such a case the claims of family members incurred before December 31, 2013 would be dealt according to the previous legislation and claims dated after the record day according to the new Civil Code..

### 3.6 Non-application of the legal rules for family enterprise

The legal regulation of family enterprise shall not apply where the rights and obligations of the family members involved in the operation of the family enterprise are covered by a contract, whether it may be articles of association, memorandum of association, silent partnership, co-operative statutes, labour or other similar type of contract. The contractual regulation shall always take precedence over the rules on family enterprise, i.e. will apply where family members involved in operation of a family enterprise don't have any other legal guarantee of their rights and obligation.

The rules on family enterprise shall also not apply in the event when in the operation of family enterprise are involved the spouses alone. Here the Civil Code explicitly prefers the rules on matrimonial property law. Thus, the rules on Family enterprise can be held for subsidiary regulation as its application shall occur only when there is no prevalence of the above defined statutory or contractual rules.

With respect to the prevalence of the matrimonial property law the question must be asked whether a family enterprise can be founded only under the participation of the spouses. We hold that this is not the case even in situations should the commercial enterprise be in the ownership of one of the spouses and the other is personally involved in the operation of the latter or works for the family on permanent basis. In situation like this the rules on joint ownership of the spouses shall apply on the property rights for the operation of such commercial enterprise as the profit from the operation of what belongs only to one of them forms part of the joint ownership of the spouses. The question, however, is whether, for the other spouse who is involved in the operation of the family enterprise but is not the owner thereof, it would not be more useful to be in a position of the family member involved in the operation. Such a member namely is not only entitled to the profit share but has also the right to participate in the decision-making on principal questions concerning the operation of the enterprise outside the usual business and in questions on the disposal with the enterprise. Merely on the basis of being a spouse and participation on the joint ownership of the spouses under statutory rules (SOLIL, J., 2014). These rights do not belong to the other of the spouses under the rules of matrimonial property law<sup>5</sup>.

### 3.7 Claims of family members involved in the operation of the family enterprise

Civil Code specifies as the basic right of family members involved in the operation of the family enterprise the right to participate in profits from this operation. The legislation does not specify more detailed conditions for determination of the amount of profit share of each member with the exception of the rule that each family member should participate in the extent corresponding to the amount and type of his work. It follows from the wording of the legal provision that the decision-making of family members is subject to the use of the entire profit of the family enterprise and, therefore, not only the part that is intended for distribution among members of the family. Should this conclusion be accurate, it means that members of the family by their decision affect what portion of the profit will be invested back for the development of family enterprise, its maintenance and operation and what portion will be divided among family members. Family members are therefore capable to influence the primary business decision-making on the use of the profit in its entirety. The decision on the use of profits from the family enterprise belongs to all family members involved in the operation

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<sup>5</sup> The reason for the usefulness of the rules family enterprise may be, inter alia, the fact that, pursuant to Section 118 Labour Code, there can be no employment relationship between the spouses



of the family enterprise, and this decision is taken by a majority of votes. At this point it should be noted that the Civil Code does not rule on the share of family members involved in the operation of the family enterprise to cover the loss of the family enterprise. We may hold that the entire business risk is borne by the owner of the family enterprise. The legislation also doesn't rule for the obligation of the involved family members to provide any cash or non-cash deposits to the family enterprise. We hold, however, that the members of the family can mutually agree on the provision of deposits for the owner of family enterprise.

In spite of the fact that the Civil Code regulates the entitlement of the family members as the claim for share on the profit, it seems as a proper interpretation that the family members are not entitled to a regular income for their personal work for the family enterprise. With regard to the terms used there is no reason to consider the profit for something different than the result of the current accounting period. If that were the case, then the subject of decision of the family members shall be only the so called net profit, i.e. the profit, after deduction of the tax duty chargeable to the owner of the family enterprise, after deduction, when applicable, of social security contributions and contributions to the State employment policy and health insurance premiums.

We can accept the interpretation that a family member will be entitled for his work for the family enterprise to receive incomes, this regardless of whether the family enterprise earns profits or not. This conclusion is also supported by the tax legislation that rules for the taxation of income of family members involved in the operation of the family enterprise and not for taxation of earned profits.

The law does not rule for payment of profit shares exclusively in cash. We can therefore hold that a consideration can be also accepted. However, this will be in the competence of the family member community.

Family members involved in the operation of the family enterprise can waive their claim to profit shares, this in the form of a notarial deed. This rule is undoubtedly a mandatory one. However, it is questionable whether the members involved in the operation of the family enterprise may define by mutual agreement rules for more accurate profit distributions and concrete extent to which they will participate in the earned profit. We are of the opinion that this may be the case, if such agreement is not a waiver of the right to profit shares by some of the members. We also hold that family members involved in the operation of the family enterprise can agree on what part of the profit shall be distributed among them, and will not be used for further operation of the family enterprise.

If during the operation of the family enterprise some gains should be incurred, all family members are entitled to them, this to the same extent as to profit shares. They are entitled, to the same extent, to properties acquired from the profit earned. Therefore, the question is, what represents the gains to the family enterprise, and what claims arise to family members therefrom. Also in this case there are significant interpretation problems. We may not exclude the interpretation that the gains to the family enterprise are not identical with the commercial enterprise and become a separate property falling to the co-ownership of family members.

The share of each family member should be determined by the extent of the amount and type of his/her work. Should this interpretation be correct, then the concept of „collective asset“ (*universitas rerum*) the concept of mass as ruled by the provisions of Section 501 Civil Code shall be lost. Among the characteristics of collective assets belongs the definition that it is a set of two or more separate assets, all of which belong to the ownership of a single person and are used for identical purpose. And this would not be the case if the gains to the family enterprise and property acquired from the profit would fall to the co-ownership of family members. Therefore we incline to the conclusion that the claim to the share of family member on the gains to the family enterprise or on property acquired from the profits of the family enterprise should be settled in cash, this in the case of termination of its involvement in the

family enterprise. The family members can waive the claims to gains and shares in property by a statement in the form of notarial deed. In the case that we admit the emergence of co-ownership shares to gains and property acquired from profit, this will bring great legal uncertainty for the owner of the family enterprise. Further on, the situation may arise that the family enterprise ceases to have the character of an organized set of assets eligible for running the business.

Further rights of family members involved in the operation of the family enterprise we consider for substantial, since they significantly restrict the ownership right of the enterprise owner. Family members in a family enterprise shall have the right to participate in decision-making with respect to operation of the enterprise and the disposal with the enterprise outside the regular operation. The Civil Code explicitly provides that the principles concerning the operation of the business or its closing down are reserved for the decision of the family members. To interpret properly the questions, what kind of changes specifically have to be decided will be the task of the application practice and the case law. However, we may presume that these issues involve changes of the subject of business, changes of the established place of business of the enterprise, changes in organizational structure and management and/ or questions of further development of investments in the operation of the family enterprise (ŠVESTKA, J., DVOŘÁK, J., FIALA J., ZUKLÍNOVÁ, M. e. a., 2014, sv. II). And, lastly, the decision on termination and dissolving of the family enterprise<sup>6</sup>. Family members have, unless stipulated otherwise, the pre-emption right to the family enterprise, which is to be disposed. Thus, the pre-emption right belongs to family members also in the case of assignment of the enterprise by donation. The legislation rules explicitly that even in the case of disposal of the property that, by its and designation, should permanently serve for the operation of the enterprise, the family members possess the pre-emption right. In practice, we may expect that family members will benefit from this pre-emption right even as regards the immovable properties belonging to the family enterprise. Due to the fact that the nature of the commercial enterprise as a family establishment is not recorded in any public register and cannot be ascertained from public sources, the person acquiring the property will not be able to find out prior to the conclusion of the purchase agreement that the transferor is restricted by the pre-emption right of the family members.

### 3.8 Transfer of the participation in family enterprise

The legislation is based on the non-transferability of participation of family members. Any claims of family members have personal character and are non-transferable. An exception is allowed if and only if the transferee is one of the family members exhaustively defined by the provisions. Section 700(1) Civil Code and all family members who are involved in operation of the family enterprise agree with such transfer of participation. It is therefore obvious that the transfer can occur only if the person who transfers or assigns ceases to be involved in operation of the family enterprise personally and this will be taken over by the person of transferee, who meets the preconditions therefor, being a relative or brother-in-law of the owner. The legislation does not rule on the contract to transfer the participation in a written form and does not provide for the prior consent of family members as a condition for the implementation of the transfer. It is therefore possible that the transfer will occur also on the basis of an oral agreement, which shall be approved subsequently by all family members involved in the operation of the family enterprise. In the event that such consent was not given and the transfer or assignment would have taken place without the consent of all family members, we may hold such act for invalid due to the fact that the rule of Section 703 Civil

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<sup>6</sup> We consider the resolving of this question for essential. In the case the owner of a commercial enterprise should not be allowed to cease, according to his/her own will, the operation of the commercial enterprise run as family enterprise, it can be expected that it will be more suitable for owners to give preference to contractual arrangement with working family members

Code ruling for the transfer of participation has mandatory character. It is therefore a legal rule that does not allow for any derogation and legal act arranging for transfer or assignment of the participation would, without the consent of family members, conflict by its content with the law (LAVICKÝ, P. e. a., 2014). If we agree with this argumentation we shall conclude that this is the case of absolute nullity. With regard to the fact that we may expect a broad spectre of opinions concerning the degree of the invalidity and or character as the statutory rule - mandatory or relatively mandatory, we may admit that the invalidity is a rule provided to protect the family members involved in the operation of the family enterprise, that may be invoked only these members that are protected by granting the right to provide consent to the transfer/assignment of the participation. Another issue of interest is the assessment of the legal conduct, on the basis of which the transfer of participation to other person than to a family member referred to in Section 700 (1) Civil Code would occur. In such a case, we can conclude that this would be a legally non-existent conduct.

We can presume that the transfer in accordance with the legislation can occur even for consideration. We hold at the same time that only the case law will resolve the question whether by the transfer of participation the claims and rights associated therewith shall be transferred as well, for example, entitlement to payment of profit for the period preceding the transfer of participation. Making this conclusion we should deal with the fact that the transfer of participation has the same consequences for the family member whose participation terminates, as the cease of the involvement in the operation, according to Section 705 Civil Code (LAVICKÝ, P. e.a., 2014). We believe that this is not so and that the transfer of the participation is mentioned by the legislator deliberately in a separate provision than the one that terminates the participation. We tend to believe that with the transfer of the participation rights associated with the involvement in the operation of the enterprise are transferred as well and therefore the unpaid and outstanding claims shall follow. Thus we may interpret the assignment in that way that the legal status, which enjoys the family member in question, shall be assigned to another member in unchanged extent. We must realise that in the transfer of participation the family member cannot apply the pre-emption right.

It remains a question whether the transfer of participation to other family member can occur in the case of a death of family members. This conclusion we may refuse because by the death of a family member involved in the operation of the family enterprise its participation ceases and outstanding claims from this participation should be subject of the succession.

### 3.9 Termination of participation of a family member

Family member's involvement in the operation of family enterprise shall cease in the case he/she stops to perform work for the family. The Civil Code does not specify any formal requirements to this termination and it can be therefore expected that the demise shall occur by a *de facto* cease of work for the family enterprise. Another reason for the termination of the participation of a family member may be that he/she concludes an employment contract or similar contract or enters in another relationship with the owner of the commercial enterprise that precludes his/her participation in the family enterprise. It can be expected that with regard to the eligibility requirements for family members entitled to be involved in the operation, the termination may occur by cease through divorce of the marriage that is basis for the brother-in-law relationship. And, finally, the termination of the participation of a family member occurs also by his/her death.

For practical reasons, we consider for necessary that the termination of involvement in the operation of family enterprise shall occur also due to a unilateral act of the owner of the enterprise or on the basis of the decision of the family members involved in the operation of the family enterprise. We may admit that in the application of this unilateral termination of involvement the practices and conventions set during previous operation of the enterprise. On the other side, completely unclear is the specification of claims arising to a member family

member upon termination of its involvement in the operation of the enterprise and their settlement. According to the wording of Section 706 Civil Code we may expect that the entitlement of the member is of pecuniary nature as the rules admit that it may be broken down into instalments should an agreement to such end be concluded or instalments shall be approved by decision of the Court. However, there isn't any closer definition of nature of this claim and its amount. We may suppose that the legislator refers to settlement of all claims of member whose participation terminated and, therefore, including the share on the gains and property acquired from the profits of the family enterprise, which we consider for a meaningful interpretation. This means that obviously the member's share in the property shall be settled. If it stands up to the conclusion of a mutual ownership to these increments and things taken from the profit, it would be a cancellation and settlement of the mutual ownership, when a family member whose participation to lapse, would always be entitled to a settlement amount in the money. If the conclusion on the co-ownership by shares in there gains and property acquired from the profits will stand, it would be a cancellation and settlement of the co- ownership, where a family member whose participation shall terminate, is always entitled to a settlement share in money. Due to the fact that the person that shall be obliged to pay the share, would be probably the owner of the family enterprise – even if the legislation completely avoids this issue – the claims of the former member would accrue to the ownership of the owner of enterprise. Associated issues to the latter are whether the profit of the family enterprise can be used for repayment to a former member and whether there is any obligation to repay the Member with participation terminated, shall not arise to all family members whose involvement in the enterprise continues. Specification as to whom the claim on the settlement upon the termination shall be raises will therefore remain to be settled by the case law. Whereas the question of locus standi in this dispute seems to be clear, different conclusions can be reached with regard to the legal capacity to be sued. The authors of this paper are of the opinion that the latter belongs only to the owner of the family enterprise.

### 3.10 Dissolution of the family enterprise

As we have defined one of the characteristics of family enterprise is its keeping in the operation, we may conclude that the family enterprise ceases to exist due to the suspension of its operation that is not of a temporary character. To the dissolution of family enterprise comes by its disposal and we expect that also due to the succession to the family enterprise. The question is whether the dissolution of the family enterprise occurs when the one or more of the family members make use of their pre-emption right to the family enterprise (ŠVESTKA, J., DVOŘÁK, J., FIALA J., ZUKLÍNOVÁ, M. e. a., 2014, sv.II). And, naturally, the dissolution of the family enterprise can also occur by agreement of the persons involved in its operation.

We hold that the existence of the family enterprise shall be influenced by declaration of bankruptcy on the property of its owner. To continue in the operation of the enterprise as family enterprise after such declaration would be contrary to the principles of the bankruptcy proceeding and the operation of the enterprise would also interfere with the disposal rights of the liquidator of the bankruptcy. We may also find the interpretation that the operation of the family enterprise may be terminated due to the circumstance that the liquidator of the bankruptcy will not declare towards the family members involved in the operation of the enterprise within 30 days after declaration of the bankruptcy that he shall meet their requirements. This interpretation rests on the provision of the Bankruptcy Proceedings Act that affects the contracts on fulfilment of mutual obligations, so far as they remain unfulfilled on the opening day of the bankruptcy by the other party to the contract as well. With regard to the fact that the existence of a non-fulfilled contract is the condition for application of this statutory provision – and we characterise the family enterprise as arrangement of contract-free

relationships between family members, we may hold this provision of the Bankruptcy act for non- applicable to the family enterprise.

#### 4. CONCLUSION

In conclusion of our analysis and considerations, we should remind you that, unless otherwise provided by law, family members can rule for their rights and obligation in a way of derogation from the law. Prohibited are only legal acts that *contra bonos mores*, violating the public order or rights relating to the personal status of persons, including rights for protection of the personality of individuals.

In the their next years, after the settlement of the re-codifying rules of the Czech civil law, we may expect further interpretation of the rules on family enterprise by the case law of general courts to be established on this issues, but also the one of the administrative courts, e.g. in the context of defining the legal and illegal labour in the decisions of the labour inspectorates relating to bailout the family without labour relations<sup>7</sup>. In the event that the labour will be defined as personal performance of a family member, we shall exclude the conclusion that it could be held for illegal labour.

At present, some professional workplaces in the Czech Republic are considering wheter to include the modification of the family plant The Business Corporations Act and exclude it from the Civil Code. Any amandment or non-complecion of the Business Corporations Act must be carefully assessed by our court and the evaluation (analysis) of the existing adjustment must be carried out first.

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<sup>7</sup> These questions are dealt by the case law already several years before the introduction of the institute of the family enterprise. Most consequently were the features of dependent labour defined by the Supreme Administrative Court in its decision of December 13.02.2014, sp. zn. 6 Ads 46/2013. Available at [http://www.nssoud.cz/files/SOUDNI\\_VYKON/2013/0046\\_6Ads\\_13\\_20140220123634\\_.pdf](http://www.nssoud.cz/files/SOUDNI_VYKON/2013/0046_6Ads_13_20140220123634_.pdf)

## **Contact address**

prof. JUDr. Karel Marek, CSc.  
Faculty of Laws and Administrations Studies – University of Finance and Administration,  
Estonská 500, Prague 10, 101 00  
( [k.marek@centrum.cz](mailto:k.marek@centrum.cz) )

doc. JUDr. Martin Janků, CSc.  
Faculty of Laws and Administrations Studies – University of Finance and Administration,  
Estonská 500, Prague 10, 101 00  
( [jan.kum@seznam.cz](mailto:jan.kum@seznam.cz) )

