Journal of the University of Latvia. Law, No. 17, 2024 pp. 68–79

https://doi.org/10.22364/jull.17.04

Compensation for Losses in Latvian Groups of Companies Law

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The main purpose of the legal regulation of groups of companies, i.e. the Groups of Companies Law of Latvia, is to protect rights and legitimate interests of the dependent company, its creditors and minority shareholders. A controlling enterprise is entitled to pursue its own economic interests by exerting the decisive influence on a dependent company. There is no general prohibition for a controlling enterprise to induce the dependent company into entering transactions or carrying out measures that are disadvantageous to the dependent company. Disadvantageous transactions have to be reflected in the yearly dependency report submitted by the board of the dependent company. As a general principle, the controlling enterprise shall compensate the dependent company for losses arising from disadvantageous transactions or undertakings. If a group contract between the controlling enterprise and the dependent company exists, legal representatives (board members) of the controlling company are jointly responsible for the losses of the dependent company. If a group contract has not been concluded and a *de facto* group of companies exists, the controlling enterprise itself has to compensate for the losses of the dependent company. Besides the controlling enterprise, the legal representatives of this enterprise are jointly responsible.

Keywords: compensation for losses, controlling enterprise, dependent company, legal representatives of the controlling enterprise, disadvantageous transactions, other disadvantageous measures.

Contents

Introduction

In recent years, the role of groups of companies law has been gaining momentum in the Latvian legal system. Of particular importance are the provisions of the Groups of Companies Law[1] on compensation of losses, namely, the obligation of the controlling company and its legal representatives to indemnify the dependent company for losses incurred by the dependent company after the controlling enterprise induced the dependent company to enter into a disadvantageous transaction or to carry out other measure disadvantageous to the dependent company. The Latvian Groups of Companies Law been in force since 2000, but the provisions of this law, which were basically adopted from the provisions of the German Stock Corporation Act (*Aktiengesetz*) or for which the above-mentioned German regulation served as a model, have only gradually gained wider application in Latvia. The increasing practical importance of groups of companies is reflected, *inter alia*, by the increase in the number of groups of companies cases heard by the courts.

As emphasised by the Supreme Court of the Republic of Latvia (Senate), when interpreting the Groups of Companies Law, it should be taken into account that the origin of the provisions of this law reflects the influence of the German Stock Corporation Act (*Aktiengesetz*) and therefore the tradition of the application of German law is relevant for the correct understanding of the provisions of the Groups of Companies Law.[2] Furthermore, the legal literature rightly points out that a judge hearing a case concerning groups of companies law must be prepared for the parties to rely on the German groups of companies law in their arguments.[3]

Protecting the economic interests of a dependent company in its relationship with the controlling enterprise is one of the core functions of the groups of companies law. The right of a dependent company to obtain compensation for losses suffered from the controlling enterprise or, in certain cases, from its legal representatives is one of the most important legal means of ensuring the practical protection of those interests. This legal mechanism may also be used by the dependent company's creditors in bringing an action against the controlling enterprise. The relevant provisions of the Groups of Companies Law are quite complicated and the present article is devoted to the aspects of their application in Latvia.

1. Relations of the controlling enterprise and the dependent company: General overview

The dependent company's position under the influence of the controlling enterprise is the reason why the controlling enterprise is able to subordinate the dependent company to its own interests. As indicated in the Latvian groups of companies law literature, the common interests pursued by a group of companies are usually concentrated in the controlling enterprise, which is the beneficiary of

[1] Koncernu likums [The Groups of Companies Law] (23.03.2000). Available: https://likumi.lv/ta/id/4423-koncernu-likums [last viewed 15.04.2024].

[2] The Judgment of the Supreme Court (Senate) of the Republic of Latvia from 31 May 2022 in case No. SKC-44/2022, para. 11.3. Available: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs/civillietu-departaments/klasifikators-pec-lietu-kategorijam/komerctiesibas/citi [last viewed 10.04.2024].

[3] *Brants, E.* Prasības, kas izriet no koncernu tiesiskajām attiecībām [Claims arising from legal relations in groups of companies]. Jurista Vārds, 01.12.2020, No. 48(1158), p. 35.

the group's activities.[4] It is naturally acceptable that the controlling enterprise uses a dependent company to pursue its own economic interests for profit. In order to explain the legal mechanism that allows the controlling enterprise to benefit from the dependent company, including the benefits that arise as a result of transactions or arrangements that are disadvantageous to the dependent company, it is necessary to explore the concepts of controlling enterprise and dependent company, as well as the framework of the legal relationship between those entities.

A group of companies is an aggregate of a controlling enterprise and one or several dependent companies (Article 1, Section 1 of the Groups of Companies Law). A dependent company, as defined in Article 2, Section 3 of the Groups of Companies Law, is a company under the decisive influence of the controlling enterprise and is located in Latvia. According to the provisions of Article 1, Section 2 of the Groups of Companies Law, a controlling enterprise is an enterprise which has a decisive influence in one or more companies and is located in Latvia or abroad. Article 2, Section 4 of the Groups of Companies Law specifically states that this law, with the exception of the provisions on creditor protection, shall not apply where a natural person owns all the shares or stocks in one company.

The concept of an enterprise, which also determines a controlling enterprise, is defined in Article 1 of the Groups of Companies Law. According to Item 8 of the said Article, an enterprise is a commercial company within the meaning of the Commercial Law[5], or a natural person.

It should be noted that the concept of an enterprise is often defined and understood differently in different sub-branches of Latvian private law. Under the Commercial Law, an enterprise as a collection of tangible and intangible property and other economic benefits belonging to a merchant, is regarded as an object of law (Article 18 of the Commercial Law). In Latvia, the Groups of Companies Law is considered a part of commercial law. However, for practical purposes and for convenience of terminology, in the Groups of Companies Law the term "enterprise" refers to commercial companies and natural persons as subjects of law.

Commercial companies within the meaning of the Commercial Law are the following four types of companies regulated by that Law: limited liability company, joint stock company, general partnership, limited partnership. An individual merchant, i.e. a natural person registered in the Commercial Register for purposes of commercial activity, can also be a controlling enterprise in the sense of the Groups of Companies Law. Moreover, any natural person, regardless of its legally significant characteristics, may be a controlling enterprise within the meaning of the Groups of Companies Law.

The cause of the dependency is the decisive influence of the controlling enterprise over the dependent company. The decisive influence may be direct or indirect, depending on whether the controlling enterprise exercises that influence over the dependent company through another dependent company or without the mediation of another dependent company, in accordance with the provisions of Article 4 of the Groups of Companies Law. The basis for the exercise of decisive

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[4] *Strupišs, A.* Koncernu likuma darbības efektivitātes problēmas un to tiesiskie risinājumi [Effectiveness problems of the Group of Companies Law and legal solutions to them]. 2007, p. 3. Available: https://www.at.gov.lv/files/uploads/files/7_Resursi/Petijumi/lv_documents_petijumi_Koncerni.pdf [last viewed 10.04.2024].

[5] Komerclikums [The Commercial Law] (14.04.2000). Available: https://likumi.lv/ta/id/5490-komerclikums [last viewed 10.04.2024].

influence is either a group of companies contract between the controlling enterprise and the dependent company or the controlling enterprise's participation in the dependent company (Article 3 Section 1 of the Groups of Companies Law).

According to Article 3, Section 2 of the Group of Companies Law, there are three types of a group of companies contract: 1) a management contract; 2) a profit transfer contract; and 3) a management and transfer of profit contract. A group of companies based on any of those contracts is known as a contractual group of companies.

According to Article 3, Section 3 of the Groups of Companies Law, an enterprise has a decisive influence in a company on the basis of a participation if at least one of the following circumstances exists: 1) the enterprise has a majority of voting rights in the company; 2) the enterprise, as a shareholder of the company, has the right to appoint or remove a majority of the members of the company's executive or supervisory body; 3) the enterprise is a shareholder of the company and, exercising only its rights of a shareholder, during the accounting year has appointed the majority of members of the executive body or of the supervisory body of the company; or 4) the enterprise is a shareholder of the company and, on the basis of agreement with other shareholders, has sole control of the majority of voting rights in the company. If the participation criteria mentioned above are fulfilled, a *de facto* group of companies emerges.

The regulatory framework of the Groups of Companies Law described above indicates the extensive possibilities for the controlling enterprise to influence the dependent company in its own interests. It is evident that the Group of Companies Law applies to a wide range of legal relations in the field of commercial law. Furthermore, any shareholder of a capital company, i.e. limited liability company or joint stock company, or a member of a commercial partnership is to be regarded as a controlling enterprise in a dependent company if his participation in that company fulfils the characteristics of a decisive influence specified in the Groups of Companies Law.

2. Instructions from the controlling enterprise, disadvantageous transactions or measures as causes of loss

There is no general prohibition in groups of companies law for a controlling enterprise to induce a dependent company to enter into a transaction or take any other action that is disadvantageous to it. Nor is there a comprehensive prohibition on giving instructions to a dependent company that are detrimental to it.

For a group of companies based on a group of companies contract, i.e. contractual group of companies, as opposed to a *de facto* groups of companies, the law even mentions that the controlling enterprise may instruct the dependent company with respect to the management of the company.[6] Moreover, the instructions of the controlling enterprise may be such as to cause loss to the dependent company, provided that such instructions are in the interests of the controlling enterprise or in the interests of other companies which are merged with the controlling enterprise and the dependent company in a group of companies (Article 26, Section 1 of the Groups of Companies Law). In addition, the executive body of the dependent company is obliged to comply with those instructions, as stipulated in Article 26, Section 2, Clause 1 of the Groups of Companies Law. Article 26, Section 2 of the Groups of Companies Law provides, *inter alia*, that the right of the controlling enterprise to give

[6] See: *Windbichler, C.* Gesellschaftsrecht. 24. Auflage [Corporate Law. 24th edition]. München: C. H. Beck, 2017, § 33 Rn. 14.

instructions that cause loss may for the dependent company be limited by a group of companies contract (management contract or management and transfer of profit contract).

The obligation to compensate for losses in a contractual group of companies arises if the legal representatives of the controlling enterprise have not acted with the care of a proper and conscientious manager (Article 27, Section 1, Clause 1 of the Groups of Companies Law). However, the legal representatives of the controlling enterprise, as stated in Article 27, Section 1, Clause 2 of the Groups of Companies Law, may not, in particular, give instructions which may lead to the insolvency, administrative suspension or judicial liquidation of the dependent company.

In the case of a contractual group of companies, the Groups of Companies Law refers to instructions which cause losses for the dependent company. The provisions of the said law on liability for losses in a *de facto* group of companies mention a disadvantageous transaction or other disadvantageous measure induced by the controlling enterprise to the dependent company as a prerequisite for compensation for losses. The Supreme Court of Latvia (Senate), referring to the German doctrine of groups of companies law, has held that the basis for recovery of uncompensated losses from the controlling enterprise is any action (inducement) by the controlling enterprise to the dependent company to enter into a transaction or to carry out other measure disadvantageous to it.[7]

The provisions of the Groups of Companies Law do not explain what exactly constitutes a disadvantageous transaction or other disadvantageous measure. According to the doctrine of groups of companies law, a disadvantageous transaction is any transaction or arrangement which results in a reduction or jeopardization of the assets or income of the dependent company.[8] In determining whether a transaction is disadvantageous, it is relevant whether there is an objective disproportion between the performance and the consideration when compared to a transaction entered into by an independent third party.[9]

The inventory procedures of the assets of a commercial company, the interaction between balance sheet items and the nature of the commercial activity concerned are relevant to the determination of an disadvantageous transaction or measure.[10] The literature on Latvian groups of companies law refers, *inter alia*, to the following criteria for assessing the economic nature of corporate conduct: capital sufficiency, efficiency of economic or administrative measures, viability of the dependent company, compliance with the procedure for meeting creditors' obligations, possible ",siphoning" or "extracting" of assets from the dependent company.[11]

The case law further recognises that the disadvantage of a transaction is to be determined as of the time of the transaction, and that the standard of conduct of a proper and conscientious manager of a company, if the dominant company wishes

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[7] The Judgment of the Supreme Court (Senate) of the Republic of Latvia from 31 May 2022 in case No. SKC-44/2022, para. 12. Available: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs/civillietu-departaments/klasifikators-pec-lietu-kategorijam/komerctiesibas/citi [last viewed 14.04.2024].

[8] *Emmerich, V., Habersack, M.* Konzernrecht. 11. Auflage. München: C. H. Beck, 2020, § 25 Rn. 15; *Saenger, I.* Gesellschaftsrecht. 5. Auflage. München: Verlag Franz Vahlen, 2020, Rn. 948.

[9] *Emmerich, V., Habersack, M.* Konzernrecht, § 25 Rn. 15.

[10] *Grīnberga, I.* Kreditora interešu aizsardzība strīdos, kas izriet no koncernu tiesību pārkāpumiem [The protection of interests of creditors in disputes concerning violations of group of companies law]. Jurista Vārds. 20.09.2020, No. 38 (1148), p. 23.

[11] *Grīnberga, I.* Kreditora interešu aizsardzība, p. 25.

to exculpate itself or absolve itself of liability, is to be as of the time of the transaction or measure, and not at a later time.[12]

The principle that the influence of the controlling company which has had adverse consequences for the dependent company must be indemnified is intended to protect the dependent company itself, its minority shareholders and creditors.[13] As the Supreme Court (Senate) has recognised, the disadvantageous nature of the transaction and the loss resulting from the transaction are cumulative criteria which must be satisfied in order for the controlling enterprise to be liable for losses.[14]

It can be concluded that the prohibitions and restrictions on influencing a dependent company under the Groups of Companies Law are of relative nature, as a breach of them does not invalidate a legal transaction that is disadvantageous to the dependent company. However, instructions or inducement by the controlling enterprise may have certain legal consequences, namely, the incurrence of an obligation to compensate for losses. The details of the compensation for losses are discussed in the following sections of this article, pointing out the differences in the nuances of the liability in a contractual group of companies and in a *de facto* group of companies.

3. Compensation for losses in a contractual group of companies

Liability in a contractual group of companies is governed by Chapter IV of the Groups of Company Law, entitled "Management and liability, if a management contract or a management and transfer of profit contract are concluded". That title gives rise to the question whether the provisions of that chapter are applicable to profit-transfer contracts which do not contain management elements. As stated in the German groups of companies doctrine, which is of great importance for the correct understanding of the provisions of the Latvian Groups of Companies Law, the main difference between a management contract and a transfer of profit contract is that a transfer of profit contract, insofar as it is not combined with a management contract, does not confer on the controlling enterprise the right to give instructions to the dependent company.[15] Since the right of the controlling enterprise to instruct the executive body of the dependent company is directly linked to the existence of a management component in the group of companies contract, the provisions of Chapter IV of the Groups of Companies Law do not apply to a contractual group of companies which is based on a solely on a transfer of profit agreement. This exception should be borne in mind when discussing liability issues in a contractual group of companies.

As indicated above, the legal representatives of the controlling enterprise are obliged to exercise the care of a proper and conscientious manager when giving instructions to the executive body of the dependent company. In the event of a breach of that duty, the legal representatives of the controlling enterprise, as joint debtors, are obliged to indemnify the dependent company in accordance with the provisions of the Groups of Companies Law and, in the event of a dispute as to whether the instructions were given with due care and diligence, the burden of proof is on the said legal representatives.

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[12] The Judgment of the Supreme Court (Senate) of the Republic of Latvia from 22 December 2022 in case No. SKC-94/2022, para. 12.1. Available: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs/civillietu-departaments/klasifikators-pec-lietu-kategorijam/komerctiesibas/citi [last viewed 10.04.2024].

[13] *Hüffer, U., Koch, J.* Aktiengesetz. 11. Auflage. München: C. H. Beck, 2014, § 317 AktG Rn. 1.

[14] The Judgment of the Supreme Court (Senate) of the Republic of Latvia from 22 December 2022 in case No. SKC-94/2022, para. 12.1. Available: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs/civillietu-departaments/klasifikators-pec-lietu-kategorijam/komerctiesibas/citi [last viewed 10.04.2024].

[15] *Emmerich, V., Habersack, M.* Konzernrecht, § 12 Rn. 3.

As recognised in the doctrine of groups of companies law, the liability of the legal representatives of the controlling enterprise for the loss of the dependent company is based on the fact that, in a contractual group of companies, the management of the dependent company is effectively transferred in part to the controlling enterprise, and the legal representatives of the controlling enterprise, by giving instructions to the dependent company, in effect displace the latter's board of directors.[16]

The term "legal representatives" is understood in accordance with the provisions of the Commercial Law, namely, the board of directors of a limited liability company and a joint stock company, the members of a general partnership or the general partners of a limited partnership (for details, see Articles 91, 126, 221, 301 of the Commercial Law). By applying the findings of German legal doctrine accordingly, it follows that the legal representative's duty to act with due care and diligence also applies to an individual merchant, i.e. a natural person which has been entered in the commercial register (Article 74 of the Commercial Code), if an individual merchant is a controlling enterprise.[17]

Thus, in a contractual group of companies, the legal representatives of the controlling enterprise, and not the controlling enterprise itself, are liable for damages suffered by a dependent company as a result of instructions given by the controlling enterprise in breach of the duty of care of a proper and conscientious manager. It would be unreasonable for the legislature to have imposed liability for losses on the controlling enterprise, since, in a contractual group of companies, the controlling enterprise's decisive influence over the dependent company is established by contract, which, under the general rules of civil law, is a voluntary agreement. Moreover, the provisions of the Groups of Companies Law, as indicated above, provide for the right of the controlling enterprise even to impose instructions which are detrimental (disadvantageous) to the dependent company.

The legal structure of the liability of legal representatives in a contractual group of companies is similar to the liability of members of the board of directors for losses suffered by a capital company (limited liability company or joint stock company) under Article 169 of the Commercial Law, with the difference that the losses are not attributable to the company they represent, i.e. the controlling enterprise, but to the dependent company. Moreover, unlike the rules of Article 169 of the Commercial Law, the Groups of Companies Law does not provide for the possibility for legal representatives to exempt themselves from liability on the ground that they have acted in good faith within the framework of a lawful decision of a supervisory board.

It should be noted that, in addition to the legal representatives of the controlling enterprise, members of the executive and supervisory bodies of the dependent company are also liable for losses if they have acted in breach of their duties, in accordance with the provisions of Article 28 of the Groups of Companies Law. With regard to these persons, Article 28, Section 2 of the Group of Companies Law expressly states that the consent of the supervisory body of the dependent company to the actions of the members of the executive body does not exclude the obligation of liability. It is recognised in the groups of companies law literature that the executive body (the management board) of a dependent company will generally be liable for the impermissible execution of the instructions of the controlling enterprise, while the supervisory body (the supervisory board) should be liable for either failing to prevent the impermissible execution of the instructions or for having given its consent to it.[18]

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[16] *Emmerich, V., Habersack, M.* Aktien- und GmbH-Konzernrecht. 8. Auflage. München: C. H. Beck, 2016, § 309 AktG Rn. 4.

[17] See: *Koch, J.* Aktiengesetz. 18. Auflage. München: C. H. Beck, 2024, § 309 AktG Rn. 13.

[18] *Emmerich, V., Habersack, M.* Aktien- und GmbH-Konzernrecht, § 310 AktG Rn. 9, 21.

An action for compensation of losses may be brought not only by the dependent company itself, but also by each of its shareholders on its own behalf for the benefit of the dependent company pursuant to Article 27, Section 5, Clause 1 of the Groups of Companies Law. A claim may also be brought by a creditor of the dependent company to the extent that he is unable to obtain satisfaction of his claims from the dependent company (Article 27, Section 5, Clause 2 of the Groups of Companies Law). The right of shareholders and creditors to bring an action for compensation of losses is relevant because the dependent company, obeying the instructions of the controlling enterprise, might not wish to bring such an action.

Although the controlling enterprise of a contractual group of companies is not the debtor in respect of losses, the provisions of Article 27 of the Groups of Companies Law are also of great importance in a *de facto* group of companies, since, pursuant to Article 33, Section 4 of that Law, the provisions of the third, fourth, fifth, sixth and seventh paragraphs of Article 27 of the Groups of Companies Law apply respectively to a claim for compensation of losses against the controlling enterprise in a *de facto* group of companies.

Thus, in a contractual group of companies existing on the basis of a management, or management and sharing of profit contract, the controlling enterprise has extensive opportunities to give the dependent company instructions that are detrimental to the latter. The legal representatives of the controlling enterprise are obliged to indemnify the dependent company, but that obligation arises only if those representatives, in giving instructions to the executive body of the dependent company, have breached the duty of care of a proper and conscientious manager.

4. Compensation for losses in a de facto group of companies

The conditions for indemnification of a dependent company in the absence of a group of companies contract are governed by the provisions of Chapter V of the Groups of Companies Law. As mentioned above, in that case a *de facto* group of companies exists. In the light of what has already been said in the previous section, it should be noted that Chapter V of the Groups of Companies Law can be applied not only to a *de facto* group of companies but also to a group of companies bound by sharing of profit contracts. Such contracts are more likely to be the exception, however, as most group contracts tend to be management and transfer of profit contracts combining elements of both types of a group of companies contract.[19]

Although in a *de facto* group of companies there is no absolute prohibition for the controlling enterprise to induce a dependent company to enter into a transaction or other measure disadvantageous to it, the controlling enterprise shall abstain from exerting its decisive influence in this way if the dependent company is not compensated for the loss resulting from the disadvantageous transaction or other disadvantageous measure. If the controlling enterprise does not actually compensate for those losses by the end of the accounting year, or does not grant an adequate compensation claim, it is obliged to compensate for losses incurred by the dependent company (Article 33, Section 1, Clause 1 of the Groups of Companies Law).

In addition, pursuant to Article 33, Section 1, Clause 2 of the Groups of Companies Act, the controlling enterprise is also obliged to indemnify the shareholders of the dependent company against any loss suffered by them as a result of the conduct in question, irrespective of any loss suffered by them as a result of the loss suffered by the dependent company. In the latter case, it is not the dependent company's but

[19] *Emmerich, V., Habersack, M*. Konzernrecht, § 12 Rn. 2.

the shareholders' own individual losses, for example, a reduction in the dividend.[20] The so-called ",reflex losses" that affect shareholders because of the losses suffered by the dependent company as a result of a disadvantageous transaction or disadvantageous measure are, according to the capital preservation principle, attributed to the losses of the dependent company and cannot be claimed by the shareholders.[21]

In addition to the controlling enterprise itself, the legal representatives of the controlling enterprise who induced the dependent company to enter into a disadvantageous transaction or to carry out a disadvantageous measure are liable as joint debtors (Article 33, Section 3 of the Groups of Companies Law).

In accordance with Article 30 of the Groups of Companies Law, transactions entered into for the benefit or at the inducement of the controlling enterprise which are wholly or partly disadvantageous to the dependent company must be disclosed in the dependency report drawn up by the executive body of the dependent company. The dependency report has to be drawn up for each accounting year and approved together with the company's annual accounts. In the groups of companies law literature, the dependency report has been described as an instrument for controlling the actions of the controlling enterprise.[22]

According to the provisions of the Article 30 of the Groups of Companies Law, the dependency report must indicate, *inter alia*, the performance and counter-performance of the disadvantageous transactions, as well as the basis for the disadvantageous measures, the benefit derived therefrom and the loss incurred. The dependency report shall also indicate the measures carried out during the accounting year to effectively compensate the dependent company for the losses incurred, the amount of losses incurred during the accounting year and the right of compensation claim conferred on the dependent company to the extent that the losses have not been compensated during the accounting year.

Under Article 34 of the Groups of Companies Law, members of the executive body of a dependent company are liable in addition to the controlling enterprise and its legal representatives for losses suffered by the dependent company if, in breach of their duties, they have failed to disclose in the dependency report an disadvantageous transaction or a disadvantageous measure and the unreimbursed losses resulting therefrom, or failed to comply with the obligation to report those transactions and measures to the meeting of shareholders.

However, as stated in Article 33, Section 2 of the Group of Companies Law, the controlling enterprise does not have to compensate for losses if it proves that a proper and conscientious manager of an independent enterprise would have acted in the same way. The Supreme Court (Senate) has held that the legal structure of liability governed by the provisions of Article 33 of the Groups of Company Law is similar to that of Article 169 of the Commercial Code, as evidenced by the possibility of exculpation.[23]

A claim for compensation for losses against a controlling enterprise of a *de facto* group of companies may be brought not only by the dependent company itself, but also, by applying Article 27, Section 5 of the Groups of Companies Law accordingly, by each shareholder in his or her own name and for the benefit of the dependent

[20] *Emmerich, V., Habersack, M.* Aktien- und GmbH-Konzernrecht, § 317 AktG Rn. 13.

[21] *Emmerich, V., Habersack, M.* Konzernrecht, § 27 Rn. 9.

[22] *Rubene, A., Stabulniece, M.* Atbildība par atkarīgajai sabiedrībai nodarītajiem zaudējumiem [Liability for the losses of the dependent company]. Jurista Vārds. 12.11.2013, No. 46 (797),p. 38.

[23] The Judgment of the Supreme Court (Senate) of the Republic of Latvia from 18 January 2022 in case No. SKC-20/2022, para. 10. Available: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs/civillietu-departaments/hronologiska-seciba?lawfilter=0&year=2022 [last viewed 15.04.2024].

company. Similarly, under the said provision of the Groups of Companies Law, a creditor may also bring an action to the extent that he or she is unable to obtain satisfaction of his or her claims from the dependent company. The Supreme Court (Senate) has held that if a creditor is able to justify why it would be unsuccessful or pointless to proceed against the dependent company, there is no need to proceed against the dependent company first.[24] Moreover, a creditor may seek damages in its own favour, as it would be unreasonable to expect him or her to proceed first against the dependent company in order to obtain satisfaction of his or her claims against the dependent company only afterwards.[25]

The manner of compensation of the loss suffered by a dependent company as a result of a disadvantageous transaction or other disadvantageous measure is not expressly regulated by the Groups of Companies Law and is therefore subject to the general provisions of the Civil Law[26] on compensation of losses, namely, the provisions of Article 1770 et seq. of the Civil Law. In any case, the existing special provisions of the Groups of Companies Law shall be observed, including the obligation of the controlling enterprise to compensate the losses voluntarily or to grant the dependant company an adequate compensation claim before the end of the accounting year.

German groups of companies law doctrine recognises that a controlling enterprise may compensate for the loss of a dependent company by granting the latter any benefit of a pecuniary nature, i.e. a benefit measurable in money, which is appropriate to "neutralise" the loss position on the balance sheet of the dependent company.[27] An appropriate remedy may also be the participation and assistance of the controlling enterprise in the cancellation of the dependent company's disadvantageous contracts, insofar as this is practically possible.[28] If, however, it becomes necessary to bring legal proceedings to recover losses, no one can prevent the dependent company from claiming a monetary compensation. This also applies where a compensation claim is brought by shareholder for the benefit of the company or by a creditor.

Thus, the provisions of Article 33 of the Groups of Companies Law, applied in conjunction with several provisions of Article 27 of the said Law, provide a sufficiently effective mechanism for the compensation of losses suffered by a dependent company as a result of a disadvantageous transaction or other disadvantageous measure entered into at the instigation of the controlling enterprise. The relevant provisions of the Groups of Companies Law also protect the interests of the shareholders and creditors of the dependent company. It should be noted that the obligation to indemnify the dependent company for losses incurred by it in a *de facto* group of companies is twofold. In particular, the primary obligation is for the controlling enterprise, by the end of the accounting year, to compensate the dependant company for losses resulting from a disadvantageous transaction or measure on a voluntary basis or to grant the dependant company a compensation claim. This legal mechanism

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[24] The Judgment of the Supreme Court (Senate) of the Republic of Latvia from 18 January 2022 in case No. SKC-20/2022, para. 10. Available: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs/civillietu-departaments/hronologiska-seciba?lawfilter=0&year=2022 [last viewed 15.04.2024].

[25] The Judgment of the Supreme Court (Senate) of the Republic of Latvia from 31 May 2022 in case No. SKC-44/2022, para. 11.3. Available: https://www.at.gov.lv/lv/tiesu-prakse/judikaturas-nolemumu-arhivs/civillietu-departaments/klasifikators-pec-lietu-kategorijam/komerctiesibas/citi [last viewed 14.04.2024].

[26] Civillikums [The Civil Law] (28.01.1937). Available: https://likumi.lv/ta/id/225418-civillikums [last viewed 12.04.2024].

[27] *Emmerich, V., Habersack, M*. Konzernrecht, § 25 Rn. 53; *Saenger, I.* Gesellschaftsrecht, § 29 Rn. 950.

[28] *Koch, J*. Aktiengesetz. 11. Auflage. München: C. H. Beck, 2014, § 317 AktG Rn. 9.

is logical as it can be assumed that the controlling enterprise would normally not want to worsen the overall economic situation of the group of companies. If the controlling enterprise does not fulfil the obligation to compensate for losses voluntarily, the dependent company may enforce its claim in court.

Summary

A group of companies is an aggregate of a controlling enterprise and one or several dependent companies, the purpose of which is to operate in common economic interests defined by the controlling enterprise. There is no general prohibition in groups of companies law against the controlling company giving instructions or making inducements to a dependent company which have the effect of causing loss to the dependent company. However, the provisions of the Group of Companies Law protect, to the extent possible, the dependent company, its shareholders and creditors by mitigating the adverse effects of transactions entered into by the dependent company as a result of an instruction or inducement by the controlling company.

The legal ability of the controlling enterprise to influence the dependent company to improve or maintain its economic and financial position at the expense of the dependent company is not unlimited. A principle of groups of companies law is that the controlling enterprise is obliged to indemnify the dependent company for losses incurred by the latter as a result of a disadvantageous transaction or other disadvantageous measure at the direction or instigation of the parent. The prerequisites and essential aspects of the indemnification differ depending on whether the dependent company which suffers damage as a result of the conduct of the controlling enterprise is part of a contractual group of companies or a *de facto* group of companies.

Where a contractual group of companies exists on the basis of a management contract or a management and transfer of profit contract, the controlling enterprise has an expressly regulated right to give instructions to the executive body of the dependent company. In a contractual group of companies, the controlling enterprise itself is not liable for any loss suffered by the dependent company as a result of the instructions, but the legal representatives of the controlling enterprise are liable as joint debtors. Liability for losses arises only if the legal representatives have breached the duty of care owed by a proper and conscientious manager. In addition to the legal representatives of the controlling enterprise, the members of the executive and supervisory bodies of the dependent company are also liable under certain conditions.

In a *de facto* group of companies, i.e. in the absence of a group of companies contract, the controlling enterprise is not entitled to give direct instructions to the executive body of the dependent company, which is why the Group of Companies Law speaks of inducing the dependent company to enter into a transaction or carry out other measure disadvantageous to that company. In a *de facto* group of companies, the controlling company itself is liable, and, in addition to the controlling company, its legal representatives who induced the dependent company to enter into a transaction or to carry out other measure disadvantageous to it are also liable as joint debtors. As in a contractual group of company, the members of the executive and supervisory bodies of the dependent company are also liable under certain conditions. Moreover, in a *de facto* group of companies, the shareholders of the dependent company are entitled to claim the compensation for their own losses.

Any shareholder may also bring an action for damages against a dependent company in his or her own name but for the benefit of the dependent company. An

action for compensation of losses may also be brought by a creditor of the dependent company to the extent that he is unable to obtain satisfaction of his claims from the dependent company. Moreover, the creditor is not required to bring an action for the benefit of the dependent company and may claim the amount of damages in question directly in his favour. It would be unreasonable and contrary to the legitimate interests of the creditor to expect first to bring an action against the controlling enterprise or its legal representatives and then to be forced to wait for satisfaction from the dependent company.

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