

# Representation of corporations and prohibition of self-dealing

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## Introduction

In economic trading, corporations on both sides of a transaction are often represented by the same person. This often occurs within the framework of functioning groups of corporations, when a member of the management board of the parent is simultaneously a member of the management board of the subsidiary with which the parent performs operations. The Commercial Companies Code<sup>(1)</sup> does not mention the admissibility of such simultaneous representation of two corporations by the same person acting as a board member of each. However, in the Civil Code, <sup>(2)</sup> this situation is regulated with regard to the representation of two parties to a transaction by one 'attorney-in-fact'. <sup>(3)</sup> In 2018 the Supreme Court considered the issue of the same person acting as a board member of both corporations which are party to a transaction.

## Self-dealing prohibition

Pursuant to Article 108 of the Civil Code, an attorney-in-fact cannot be the other party to a legal transaction which is performed on behalf of the principal. This rule also applies when an attorney-in-fact represents both parties. A general prohibition on self-dealing is usually justified by the need to protect the principal's interests because where an attorney-in-fact represents both parties to a legal transaction, a conflict of interest will often exist.<sup>(4)</sup> Article 108 of the Civil Code provides for two exceptions to this prohibition:

- if, due to the specific facts, the possibility of infringing the principal's interests is excluded; or
- if the admissibility of such an act was expressed in the power of attorney.

An action which violates the prohibition is not absolutely invalid, but will incur the penalty of so-called 'suspended ineffectiveness'. This means that whether the legal action will take place depends on the will of the represented parties. Each party may confirm such an action. A lack of confirmation in due time, even by one of the principals, causes the action to be ineffective.

## Problem of self-dealing on basis of law of corporations

The Commercial Companies Code does not include regulations identical to those contained in Article 108 of the Civil Code. The Commercial Companies Code regulations dedicated to limited liability companies (Article 210(1)) and joint stock companies (Article 379(1)) concern only the rules of corporation representation in the case of an agreement concluded with a board member and a dispute with a board member. However, the scope of these provisions does not include the situation of simultaneous representation of two corporations by a person acting as a board member for both entities. This means that there is a legal loophole in the case of a legal transaction carried out by two corporations

which are both represented by the same person acting as a member of each corporation's management board, as no provision determines whether such an act is legally permissible. This raises the obvious question of how to close said loophole.

There has been an ongoing dispute as to the possibility of applying Article 108 of the Civil Code by analogy in the above situation. The opponents of such admissibility point to the theory of authorities of legal persons which, under Polish law, explains the way in which a legal person operates and the position of an attorney-in-fact, which does not fit with an analogous application. Further, when applying Article 108 of the Civil Code by analogy, the question arises as to where a corporation's consent to perform a given legal action should be expressed. Part of the doctrine indicates that this should be expressed in the company's articles of association.

The proponents of the analogous application of the Civil Code argue that Polish law generally prohibits self-dealing and that the structural differences between the power of attorney and the representation of a corporation by the authority are not so diametrical as to exclude the possibility of applying Article 108 of the Civil Code to corporations. The risk of infringing the interests of the represented entities is as high as the risk of infringing the interests of the principal if it is represented by the same attorney-in-fact.**(5)**

For years, case law did not analyse the admissibility of a legal action by a person who, as a member of each management board, represented both corporations that were parties to an action. However, the jurisprudence considered the possibility of the analogous application of Article 108 of the Civil Code to an action performed by an office holder of the governing body of a legal person with that legal person. In its resolution of 30 May 1990,**(6)** the Supreme Court held that:

*a natural person acting as an organ of a legal person cannot be the other party to a legal action, which he performs on behalf of that legal person, unless, due to the content of the legal action, the possibility of infringing the interests of that legal person is excluded.*

The adjudicating panel also pointed out that the absence of a norm analogous to Article 108 of the Civil Code in the provisions on legal persons does not justify the conclusion *a contrario* that the legislature intended to allow members of the authorities of legal persons to perform legal actions for said legal persons. In the scope of such actions, there is a lacuna in the law which should be closed by applying Article 108 of the Civil Code by analogy.**(7)** In recent years, the Supreme Court has increasingly issued unified decisions regarding the application of Article 108 of the Civil Code to legal persons.**(8)** However, this does not answer the question about the admissibility of the same person acting as a member of the management board of both corporations which are parties to a transaction.

Only in its judgments of 19 June 2002**(9)** and 24 July 2009**(10)** did the Supreme Court directly refer to this problem by refusing to apply Article 108 of the Civil Code in a situation in which the same natural person was a member of the authorities of two corporations carrying out a specific legal act. Therefore, the recent Supreme Court judgment of 24 April 2018 is all the more noteworthy,**(11)** as it constitutes a decisive break from that line of opinion. In this decision, the Supreme Court noted that:

- it is possible to apply Article 108 of the Civil Code by analogy to activities undertaken as an authority of a legal person. However, this should be preceded by an analysis of the specific facts, as there are no grounds for automatically extending the application of Article 108 of the Civil Code to every situation in which the same natural person is a member of a body of two companies that it represents; and
- a member of a management board who represents both parties to a transaction should ensure that at least one of the conditions indicated in Article 108 of the Civil Code justifying the execution of actions 'with oneself' is fulfilled.

## **Comment**

The Supreme Court judgment of 24 April 2018 is another example – in addition to the amendment of Article 39 of the Civil Code**(12)** – of the assimilation of the construction of representation of a legal person by a body (management board) and the construction of a power of attorney. Theoretically, it is also possible to consider the analogous application of Articles 210 and 379 of the Commercial Companies Code not only with regard to company agreements with members of the management board, but also to agreements in which these members of the management board

would also act as representatives of another party. However, the courts have not considered this possibility to date, which seems to stem from the fact that Articles 210 and 379 of the Commercial Companies Code, as exceptions to the rule, are not interpreted extensively.

Bearing in mind the issues outlined above, two solutions may be considered which would reduce the legal risk in this context – especially in light of the 2018 Supreme Court judgment. First, parties should avoid – as much as is possible – the same member of a management board representing both corporations in a legal transaction. Instead, corporations should be represented by two different persons in all cases where their management board is of a collegial nature. Where management boards remain single, consideration may be given to the admissibility of a power of attorney to a single board member to perform the legal action under the described conditions. However, such an action may be interpreted as an attempt to circumvent the law – in particular, the analogously applied Article 108 of the Civil Code. Therefore, a safer approach would be to include a clause in the company's deed (articles of association) allowing management board members to conclude contracts in a situation where they also act as representatives of the other party to the transaction. However, such wording of the corporation's articles of association would give the managers wide discretionary power; hence, the clause in question should be carefully considered by the shareholders and formulated as precisely as possible to clearly define the situations in which it is permissible for one person to act as a board member for both parties to a given transaction.

*For further information on this topic please contact Mirosław Cejmer or Jacek Becker at Kubas Kos Galkowski by telephone (+48 22 206 83 00) or email (miroslaw.cejmer@kkg.pl or jacek.becker@kkg.pl). The Kubas Kos Galkowski website can be accessed at [www.kkg.pl](http://www.kkg.pl).*

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## Endnotes

(1) Act of 15 September 2000, Commercial Companies Code, *Journal of Laws*, 2019, Item 505.

(2) Act of 23 April 1964, Civil Code, *Journal of Laws*, 2019, Item 1145.

(3) Article 108 of the Civil Code refers not only to attorneys at law or advocates, but also to a wider scope of representatives. Consequently, this article uses the term 'attorney-in-fact', which should be understood as any person who has been granted power of attorney.

(4) RL Kwaśnicki, *Zakaz czynności „z samym sobą” (Article 108 kc) i konsekwencje jego złamania na wybranych płaszczyznach spółek kapitałowych* [Prohibition of acts "with oneself" (Article 108 of the Civil Code) and consequences of its violation at selected levels of corporations], *Monitor Prawniczy* 2006, 10, p 138.

(5) For example RL Kwaśnicki, *Zakaz czynności z samym sobą...* [Prohibition of self-dealing], p 139; D Opalska, *Stosowanie przepisów o pełnomocnictwie do organów osób prawnych* [Application of the provisions on power of attorney to bodies of legal persons], *Przegląd Prawa Handlowego* 2013, 10, p 28; P Sobolewski (in) K Osajda (ed), *Kodeks cywilny. Komentarz. Część ogólna* [Civil Code, Commentary, General Part], Warsaw 2017, Article 108, nb 5.

(6) III CZP 8/90, OSNC (Supreme Court case law) 1990, 10-11, Item 124.

(7) P Sobolewski (in) K Osajda, *Kodeks cywilny...* [Civil Code], Article 108, nb 5. The Supreme Court applied Article 108 of the Civil Code to legal persons because no general regulation determines the rules of representation in the case of 'actions with oneself'. However, a fragmentary regulation of this issue was included in the then binding regulations on limited liability and joint stock companies. Due to the facts of the case, the Supreme Court was unable to refer to these regulations. Therefore, the Supreme Court's argument should be supplemented by an observation that, except for a special regulation devoted to capital companies (currently Articles 210 and 379 of the Commercial Companies Code), there is no standard similar to Article 108 of the Commercial Companies Code in the regulations concerning legal persons.

(8) The Supreme Court expressed a similar view in its decisions of 29 January 2016 (II CSK 231/14), 5 December 2007 (I CNP 41/07) and 24 July 2009 (II CSK 41/09). This leads to the assumption that an analogous application of Article 108 of the Civil Code to legal persons is admitted in Polish case law.

(9) II CKN 1003/00.

(10) II CSK 41/09.

(11) V CSK 425/17.

(12) The change consisted of introducing into Article 39 of the Civil Code the possibility for a legal person (including a corporation) to confirm an action performed by a so-called 'alleged authority'. Before the amendment, such admissibility was provided only for the action of the alleged attorney-in-fact and confirmation of their action by the principal.

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Mirosław Cejmer



Jacek Becker