THE LEGAL CONSEQUENCES OF THE BREACH OF PRE-EMPTION RIGHT

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Abstract

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Pre-emption right may be agreed in the contract on sale as one of the collateral clauses. General rules concerning the pre-emption right are included in the Civil Code. These general rules apply in both the pre-emptive right stipulated in the contract between the parties (the contractual right of first refusal), as well as for pre-emptive right arising under the law (statutory right of first refusal). It can also be used in the field of commercial obligations. Generally speaking we can state that the legislation concerning the pre-emption rights is very austere, unsystematically arranged and therefore allowing for too broad interpretation with undefined limits. It means at the same time a considerable legal uncertainty in its application. Participants of the legal relationship may often find only subsequently through the case law in which cases the violation of pre-emption law occurred. The aim of this paper is to analyse individual cases of violation of pre-emptive rights, both pre-emptive right with effects of an obligation and pre-emptive rights with effects of right in rem.

pre-emption right, claims of the entitled person, infringement of pre-emption right, relative nullity

1 INTRODUCTION

The pre-emption right can be easily arranged by a purchase contract as one of the accessory agreements. General legal rules concerning the institute of pre-emption right are contained in the Czech Civil Code, Act. No. 40/1964 Sb. as modified by subsequent amendments. These general rules apply both to the pre-emptive right agreed between the parties of a contract (sometimes called also as the contractual right of first refusal), and to the pre-emption right arising under the statutes (statutory pre-emption right). It can also be applied in the field of commercial obligations. Generally we can thus note that the legal regulation of the pre-emption right is very austere, unsystematically codified and thus offers too much to broad interpretive framework with unclear limits. At the same time it leads to a considerable legal uncertainty in the process of its application. Parties to the legal relationship find out often only subsequently, through the case law, cases in which an infringement of the right can occur.

2 METHODS AND RESOURCES

The aim of this paper is to analyse individual alternatives of infringement of the pre-emptive right, i.e. pre-emptive right with the character of obligatory right and pre-emptive right with the character of an right in rem. The person entitled from the pre-emption right (eligible person) can choose from several options how to protect his individual right. Cumulative use of all these alternatives – as logically follows – is excluded. The present paper carries out an assessment of the optimal procedure for selection of the claims leading to the enforcement and/or recovery of the pre-emption right.

3 RESULTS AND DISCUSSION

The pre-emption right is infringed when all the conditions and procedures for the implementation of the pre-emption right which the participants agreed in the event of this right are not met. In the case of statutory pre-emption right this happens if not all terms and requirements of the statutes are respected. It goes without any doubt that the legal consequences of the infringement of pre-emption
Right occur in the case when the liable person does not respect the pre-emption right and makes no offer to the eligible person.

However, there is a breach of the pre-emption right also in the case where the person liable according to the law or bond by contract does not wait till the end of the period of time, reserved for the entitled person to administer his right and/or to pay the price. The infringement of legal relationship established from the pre-emption right occurs even if the liable person makes properly an offer to the entitled person with the notification of all conditions, however, the entitled person did not considered it – with respect to the content of the conditions – for acceptable, and, consequently, the obliged person transferred the property to a third party at variance with the conditions, especially at more preferable terms than the conditions offered to the entitled person (particularly at a lower price). The infringement of legal relationship established from the pre-emption right is an objective condition and the law attaches to it certain unfavourable legal consequences in order to prevent abuses and/or to provide for some form of reparations.

In general, the infringement of any type of the pre-emption right brings along the consequence that the primary obligation of the obliged person – to offer to buy a property – ceases to exist, since it is not legally possible to continue to enforce it due to the change in person of the owner. At the same time, however, as a result of the breach of the obligation, a new, so-called secondary obligation, shall arise. The secondary obligations, however, do not affect the legal title, on the basis of which the transfer of the property – contrary to the pre-emption right – occurred. In other words, the contract between the obliged person and the third party shall not become automatically void and null, but the legal regulation provides for the entitled person other instruments, how to proceed in defending his individual rights.

If there is an alienation of a property in the case where the pre-emption right was applicable and at the same time an infringement of the right resulting from the pre-emption right occurred, the entitled person is given the opportunity to correct, at least partially, his unfavourable legal position. The specific legal consequences of a breach of the pre-emption right differ according to the nature of the infringed right, i.e. whether it is the right of obligatory character or of a right in rem.

3.1 Claims of the entitled person as regulated by the Civil Code rules

The Civil Code in the Section 603, para. 3 provides that if the pre-emption right is infringed, the entitled person shall either claim that the purchaser offers him to buy the property/thing, or the pre-emption right shall retain to him.

To this rule we should add that it is not completely understandable without a more detailed knowledge of the legal theory, the related case law and in particular of the circumstances under which this provision was adopted. The rule in question was included to the Civil Code by the Amending Act to the Code, No. 509/1991 Coll., by taking over the rules from the former Czechoslovak Civil Code, No. 141/1950 Coll.

In this way also the rules contained in the Section 376 of the (old) Civil Code No. 141/1950 Coll. were incorporated, however the wording of one of its paragraph was slightly modified and – probably for better clarity – separated into several provisions; i.e. the paragraphs 2 and 3 of this Section of the Civil Code. The second part of the sentence, related obviously to pre-emption right of the in rem character under the section 376 of the (old) Civil Code No. 141/1950 Coll., has been separated in the current regulation and shifted to the new section 603 para. 3. By that, the logical link between the pre-emption right of the in rem character and claims arising from such right was interrupted which can lead to interpretative problems and doubts whether the section 603 para. 3 of the Civil Code applies only to the pre-emption right of an in rem character (Section 603, para. 2, Civil Code) or also to the pre-emption right of an character an obligation (Section 603, para 1, Civil Code). It can appear at first sight that the claims of the eligible person exist regardless of whether he has the pre-emption right of an in rem character or of the character of an obligation. If we assume the interpretation that the legal consequences referred to in Section 603 para. 3 of the Civil Code shall apply even in the case when pre-emption right if an obligation character is infringed then the most

1 According to the judgment of the Supreme Court of 26th 4th 2001, File. No. 22 Cdo 1143/2000, there is an infringement of the pre-emptive right even if it follows from the Articles or Deed of Association stored in the collection of deeds with the Companies Register (section 112 para. 2 of the Commercial Code) that the amount charged up against the share of the partner/shareholder in the company, represented by the co-owner share in a property encumbered by the right of first refusal (section 109 para. 3 of the Commercial Code) is lower than the amount stated by the partner/co-owner in the written offer to purchase the ownership share in the property.


3 Cf. Fiala, J. (1992): “We believe that Section 603 para. 3 should be considered as a general rule, not only as pertaining to para. 2 of that Section. In other words, the consequences specified in Section 603 para. 3 shall apply to all types of pre-emption rights.”
important difference between these two types of pre-emption right shall be wiped away. Since for the
division of the pre-emption right into a right of in
rem character and right of an obligation character the
theory quotes as the main difference the stronger position of the entitled person in the case of the
infringement of the right with in rem character (in
particular its enforcement against third parties), it
would seem as logical to interpret the rule of Section
603 para. 3 Civil Code in the sense that it applies only
to the pre-emption right with the effects of the latter.
This does not, however, follow directly from the
legal provisions and it would be therefore suitable de
lege ferenda to remove this ambiguity because of the
legal certainty.

3.2 The legal consequences of an infringement
of the pre-emption right with the effects of an
obligation

For the determination of legal consequences of
infringements of the of pre-emption right with the
effects of an obligation it is necessary to assume the
circumstance that this type of right shall oblige only
persons who stipulated the pre-emption right, and
not the acquirer. As a consequence, a third person
that buys a property from the obliged person,
regardless of whether he knew about the pre-
emption right with the effect of obligation or not, is
not bound to the pre-emption right in any way, since
the right was established only as legal relationship
between the person bound by contract and the
person entitled.

Therefore, if the person bound by contract shall
not respect his duties existing between him and
the entitled person on the basis of the pre-emption
right and sells the property to a third party, the legal
duties can be imputed only to the person bound by
contract and in no way to a third party. As the owner
of the property charged with the pre-emption right
became already a third person, it is obvious that the
assignment of the property to the person entitled
without the consent of the new owner necessary for the
pre-emption right regardless of whether he knew about
the existence of this right or not.

3.3 Legal consequences of infringement of the
pre-emption right with effects of a right in rem

The eligible person affected by an infringement of
the pre-emption right with the effects of a right
in rem is entitled to sue the new owner of the
property (thing) to sell him the latter under the same
conditions or the pre-emption right shall remain
preserved for him.

It follows from this construction that the pre-
emption right with the above described legal
effects is an ius in rem, where the new owner as
the singular successor of the person bound by
contract automatically assumes by the acquisition
of ownership the obligations following from the
existing pre-emption right as right in rem. There
is no consent of the new owner necessary for the
assignment of the obligations from such pre-
emption right and the latter is bound by the pre-
emption right regardless of whether he knew about
the existence of this right or not.

For this reason, it is necessary that, in cases where
there may be a contractual pre-emption right with
effects of a right in rem is, to ensure the principle
of publicity so that the potential buyer has – by
spending of reasonable care – the opportunity
to verify independently whether the property
is burdened with pre-emption right and can
sufficiently consider his position at the conclusion
of the purchase contract.

Although the legal provisions does not explicitly
rule for the effect or pre-emption right pursuant
to Section 140 Civil code as a right in rem, effective
towards third parties, the existing case law with the
support of the authors professional legal public
grant to the pre-emption right this nature. It follows
from this conclusion that the co-owner of a property
whose pre-emption right has been infringed has not
only the claims resulting from the general provisions
on the pre-emption right as right in rem (Section 603,
pars. 3 Civil Code), but also the special claims set out
in Section 40a in conjunction with Section 140 Civil
Code.

3.4 Selection of one of the options

In summarising the above stated we can notice
that the entitled person can chose from more
options how to defend his individual right whereby
the assertion of all the alternatives at the same time is
from the logic of things impossible. Before selecting
one of them we have therefore to answer the
question whether – under the circumstances given
-the entitled person is really interested in acquiring
the ownership and whether he is capable to fulfil
all agreed conditions of the transaction. If the will of the entitled person is aimed at the immediate acquisition of the property, there is no other choice then to enforce the assignment of the property from the purchaser.

If the entitled person is unable to meet the conditions of the assignment, or if he is willing to wait with the acquisition until the new owner decides to sell the property, it is appropriate to choose the solution that we will discuss below under the point ii.

\[ \text{i. The right to reclaim that the purchaser offers to sell the property} \]

The entitled person can start the defence of his right by inviting the purchaser to revise the illegal objective status and assign voluntarily the property to the entitled person under the same conditions under that he has acquired it.

After the lapse of a reasonable period of time the purchaser is held as if he is in default with the fulfilment of its obligations arising from the infringement of the pre-emption right, and may legitimately lodge an action to the court. The sued person in this litigation is the purchaser, for only he as a new owner may validly assign the ownership to the property – subject-matter of the pre-emption right. Since the former person bound by contract cannot legally influence the assignment any more, he shall not appear in the litigation, unless he joins the litigation as the intervener under the Section 93 of the Code of Civil Procedure.

The action is by its nature directed to the replacement of the expression of will of the purchaser in accordance with Section 161 para. 3 Code of Civil Procedure. In this context, it is worth noting that the earlier case-law relating to the recently modified pre-emption right took the view that the entitled person whose pre-emption right was infringed is entitled only to the replacement of the unilateral legal act of the person bound by contract, addressed to the entitled person, therefore to replace the offer. In cases where the subject of the pre-emption right was a real estate or a share in it, and therefore there was the legal requirement of written expression of the will of the same deed, this legal opinion has emerged as unsustainable, because after closing the court proceedings it was not practically possible to enter the right of ownership of the entitled person to the land register in accordance with the requirements applicable to the entries carried out by the Cadaster Office.4

With regard to the above stated, it is therefore – within the meaning of Section 603 para. 3 Civil Code – necessary to demand delivery of the decision replacing the lack of expression of the will of the person bound to conclude the contract. As the cause of action (and the operative part of the judgment) should be quotation of text of the contract based on the same conditions as the contract between the person bound by contract and the purchaser, that infringed the pre-emption right.5 Because the purchase contract is a synallagmatic relationship, the wording of the operative part of the judgment shall express by the linking of the performance (for example, the words “against payment”, i.e., in the operative part of the judgment, it should be stated that the purchaser is obliged to conclude a purchase contract with entitled person, at the same time make the payment of the purchase price and/or meet other conditions arising out of the contract). The applicant may be therefore recommended to deposit the purchase price on a separate account or at a third party, demonstrating thereby clearly enough that he is prepared to comply with his obligation.

In the case that a real estate should be the subject of dispute, it is necessary – after the judgment in favour of the entitled person acquires legal power – to enter in the Land Register the entitled person as the new owner of the real estate. The Cadastral Office shall make the entry of the ownership right – after presentation of the judgment with the legal power clause – by a record and not by a deposit.

The present regulation of the pre-emption right, laying down the rules for joint owners, has in addition one specific feature – unless the co-owners don’t agree on the exercise of the pre-emption right they are, according to Section 140 Civil Code, entitled to purchase the assigned share, not by equal shares but according to the proportion of their co-owner shares.

If there are more co-owners, it is necessary that they agree on the exercise of the pre-emption right. They may, for example, agree - instead of the proportional purchase of the ownership share – that the entire share shall be purchased only by one of them. But the question remains whether, in the case of the infringement of pre-emption right (if no space was left an agreement of the remaining co-owners), one of them may claim the assignment of the complete share that is subject-

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4 Expression of will of the person bound by contract to make an offer for the sale of the property was indeed replaced by a judicial decision, but at the time when there is registered as owner of the disputed property the new purchaser. The offer was therefore made by the non-owner of the property who – in accordance with Section 5, para. 1, point. c) of Act No. 265/1992 Coll. - is not entitled to dispose with the subject-matter of the transaction. In addition, there is a limitation for the entry of ownership of the entitled person into the Land Register under Section 5, paragraph 1, point. a) of the Act, as to the status of entries in the register is an obstacle to the proposed entry. Cf also LUKES, L. (1996).

5 The contrary opinion takes HOLUB, M. (2002), p. 909: “he can claim the replacement of his expression of will to make an offer by judicial decision under Section 161 para. 3 of the CPC”.

matter of the assignment, when the other co-owners remain passive in claiming their rights and make no statement in any way. Since the passivity and silence can under no circumstances mean a consent, we may hold that, in this case, the co-owner who is applicant, is entitled only to the proportional part of the share and the purchaser acquires just such proportion of the co-ownership share, which otherwise would have belonged to those co-owners, who would not claim be the assignment. If the purchaser is not interested in this reduced co-ownership share, he should have the possibility to withdraw from the purchase contract, he has concluded with the person bound by contract.

**ii. The pre-emption right against the purchaser sustained**

If the pre-emption right has been infringed, but the entitled person does not require — for what reasons any — the immediate acquisition of the property, the pre-emption right of the entitled person remains sustained. The purchaser therefore continues to be bound by the pre-emption right, in particular by the duty to offer the purchase of property the at a time when he decides to sell it, preferably to the entitled person. This moment will already depend on the will of the new owner and the entitled person has no means how to enforce a sale. With regard to the possibility of limitation, it is obvious that this alternative occurs as soon as the right to claim the selling from the purchaser shall become statute-barred. Until the expiry of the limitation period the entitled person still has the option.

Whatever option from the above quoted may the entitled person choose at the moment of infringement of the pre-emption right, it is appropriate to point out that the assertion of claims against the person bound by contract by the entitled person does not automatically exclude the parallel liability of the person bound by contract for damage, which can be caused to the entitled person by the infringement of the pre-emption right.

### 3.5 Relative nullity

The infringement of Section 140 Civil Code has also as the effect the relative invalidity of the assignment of co-owner share pursuant to Section 40a Civil Code. The assignment shall be deemed valid if the person affected by it will not object the invalidity of legal act within the limitation period.

Thereof can be concluded that the entitled person who is affected by the violation of the pre-emption right may bring an action to the court in order to decide upon the invalidity of the legal act under Section 80 letter (c) of the Code of Civil Procedure, i.e. he may claim that the Court decides that the contract on the assignment of co-ownership share that is contrary to section 140 of the Civil Code is invalid, which would bring the legal status as regards the property back to the one before the assignment of the share to a third person.

It should be noted that this legal consequence has a minor practical importance. At this point, we can raise the question of the relationship between the action for nullity and action to replace the missing expression of the will.

Essential to the Court to deal with the question of invalidity in action for a declaratory judgment, is the proof of an urgent legal interest in such decision. According to the interpretation by the settled case law an urgent interest is given in particular where without the required specification the right of the applicant was threatened, or his status would become uncertain. An action is, as a rule, not justifiable, where one can sue on the fulfilment of obligations pursuant to section 80 (b) Code of Civil Procedure.

Action for a declaratory judgment under section 80 (c) Code of Civil Procedure is more of pre-emptive nature and is justified first of all where it can serve to eliminate the threat to a right or of legal uncertainty in a relationship and the corresponding remedy cannot be reached otherwise. Further on, it can be justified in cases in which an action for a declaratory judgment suits more effectively than other legal means for the content and nature of the legal relationship and the improvement can be achieved through it, that forms legal framework as a guarantee of avoiding future disputes of the parties.

These goals correspond to the existence of an urgent legal interest. If, in a particular case, it cannot be expected that the action for a declaratory judgment will fulfill them, there will be also no legal interest in such decision.

In the light of the above mentioned case-law we may conclude that cases where the co-owner will be able to claim relative nullity are not many in the practical life. In the theory, action on the determination of invalidity may succeed, for example, in a situation where the remaining co-owners whose pre-emption right has been infringed, would not be interested to acquire the assigned co-ownership share, however, at the same time they should aim to prevent a third party to enter the co-owner relationship.

We believe that in this case, the applicants bear the burden, not only concerning the proof of the urgent legal interest for the determination of the nullity of the contract, but also the burden concerning the proof of the urgent legal interest for that they want to prevent the new purchaser to acquire the co-ownership share. This would without any doubt be...
an uneasy task to achieve and would need carefully consider all the circumstances given. Should the entitled co-owners be not in the position to offer alternative solutions as who should step on the place of the person bound by contract, it would be most likely impossible to comply with the proposal for a judgement of the Court by a declaratory award.

We cannot legitimately require from the obliged person to remain as the co-owner, nor can we enforce waiver of the assignment of co-owner share due to the interference into a basic element of the ownership (co-ownership) – the rights to dispose with the property (share). In other situation – when the remaining co-owners have interest in a share on the property – nothing shall prevent them in claiming the assignment from the purchaser by bringing an action for the replacement of the expression of will, while the question of the relative nullity may be decided in the context of judicial proceedings as a preliminary question.

4 CONCLUSIONS

If we look critically at the quality of the existing legal regulation of the pre-emption right, we can express considerable reservation to the above mentioned regulation of the infringement and the consequences of infringement of pre-emption right. This concerns both the pre-emption right with character of an obligation and the pre-emption right with character of a right with effects of right. The nature of pre-emption right is constructed.

It is also necessary to point out that the terms (period of time) contained in section 605 Civil Code for paying out the subject-matter of the pre-emption right are not too convenient. These terms can adversely affect the entitled person because of the length of the period which I hold for too short, especially in the case of a real estate. However, this problem does not seem to be of such an importance, especially in the case of a real estate. However, this problem does not seem to be of such an importance, because the contract parties can modify the statutory regulated terms and thus the legal rules do not rule the infringement of pre-emption right.

We can therefore recommend under all circumstances a detailed wording of the contract as concerns the pre-emption right. Also the insisting on written form of contracts establishing pre-emption right can be of considerable help although the legal rules require this form of establishment of pre-emption right for rights in rem concerning real estates.

SUMMARY

Pre-emption right may be agreed in the contract on sale as one of the collateral clauses. General rules concerning the pre-emption right are included in the Civil Code. These general rules apply in both the pre-emptive right stipulated in the contract between the parties (the contractual right of first refusal), as well as for pre-emptive right arising under the law (statutory right of first refusal). It can also be used in the field of commercial obligations. Generally speaking we can state that the legislation concerning the pre-emption rights is very austere, unsystematically arranged and therefore allowing for too broad interpretation with undefined limits. It means at the same time a considerable legal uncertainty in its application. Participants of the legal relationship may often find only subsequently through the case law in which cases the violation of pre-emption law occurred. The aim of this paper is to analyse individual cases of violation of pre-emptive rights, both pre-emptive right with effects of an obligation and pre-emptive rights with effects of right in rem.
The entitled person from the pre-emption right can choose from several options how to defend his individual right. The paper evaluates the optimal procedure for the selection of claims leading to the recovery of pre-emption right. Before selecting one of the available options, one should answer the question whether under the facts of the case the entitled person intends to acquire the property immediately, and whether he is able to meet all agreed terms of the transaction. If the will of the entitled person is directed to the immediate acquisition of the property, no choice is left than to enforce the assignment from the purchaser. If the entitled person is not able to meet the conditions of the assignment or if he is willing to postpone the acquisition of the property until the new owner decides to sell the property, the pre-emption right shall retained to the entitled person. The purchaser stays therefore to be bound by the pre-emption right, notably by obligation of the first offer to be made to the entitled person whenever he decides to sell it. This moment will depend entirely on the will of the new owner and the entitled person shall not be capable to enforce the sale. With regard to the possibility of limitation, it is clear that this option shall arise whenever the right to claim the selling form the purchaser becomes statute-barred. Whether the entitled person in violation of the pre-emption right with the effect of right in rem chooses any from the above options, it should be pointed out that legitimate claims of the entitled person against the purchaser do not automatically preclude the simultaneous liability of the obliged person for damages that would arise to the entitled person by the breach of the pre-emption right.

REFERENCES

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