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Directors as employees?

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In the Slovak Republic it is still a quite common practice for the members of companies' statutory bodies to perform their function as employees based on the employment contract concluded pursuant to the Labor Code.

The reasons for this arrangement are various - from historical (e.g. the employment contracts with directors were written a long time ago and companies simply do not realize that this could be "wrong"), personal reasons of directors (e.g. attempts to maintain the advantages of an employment relationship, such as protection in case of termination, vacation, limitation of liability for damages, etc.), past economic advantages (e.g., social insurance payments were less or payments to directors were not tax deductible on the side of the company). Most of the said reasons (mainly the economic one) are, however, already not applicable these days as the advance payments to be paid by the company on behalf of employees or directors are more or less the same (provided that the directors receive monthly regular remuneration).

There has been a long-lasting legal discussion whether the conclusion of employment contract with the director is in accordance with the law at all. The function and performance of directors can follow two concurring legal acts – the Labor Code and the Commercial Code.

The Commercial Code requires that the function of the director has to be regulated either by: (i) an agreement on performance of the director's function, or (ii) a mandate agreement. Both options must be concluded pursuant to the Commercial Code. In order to be valid, both of these agreements need to be in writing and must be approved by the company's general meeting.

The Labor Code does not explicitly recognize "managerial contracts" (what is the mostly used term for the employment contracts with directors) and has in this respect a quite unclear provision stating that "if a special regulation stipulates an election or appointment as a condition for the performance of the function of a statutory body… the employment relationship with such employee shall be established in a written employment contract after his/her election or appointment". This provision can be interpreted that once the director is appointed by the company`s general meeting an employment relationship must be concluded with him/her. However, this concurs with the previously mentioned provisions of the Commercial Code and the non-application of the Labor Code's provisions for this relationship was also confirmed by the extensive case-law of Czech courts (where the legal system is still very similar to Slovakia) and some decisions of Slovak courts.

The courts concluded that "performance of the function of the statutory body is not performance of work in an employment relationship" and that "a person does not perform the function of the statutory body in the limited liability company in employment relationship… The legal acts or the nature of the limited liability company does not impede the possibility that other activities can these persons perform for the said limited liability company upon employment contracts if the type of work is not performance of function of a statutory body". This means that employment contracts made with the directors for work such as "director" or "general director" are deemed to be invalid. However, this does not exclude a validly concluded employment contract with the director, but this needs to be made for other working tasks than those acts that will be performed by the director pursuant to the Commercial Code and the company's by-laws. In such cases, the director would have two agreements – one concluded under the Commercial Code for performance of the function of director and another pursuant to the Labor Code for different working tasks. Needless to say, strict division of roles in two agreements is very complicated in practice.

Nevertheless, if the problematic concurrence of functions exists and the director is employed by the company for performance of working tasks as a "general director," the employment contract itself may be invalid and the acts of the individual when acting as "general director" could be challenged under certain circumstances. This risk arises mainly when there are more directors who act on behalf of the company together. Such employees act on behalf of the company solely due to the reason that they are "entitled" to do so pursuant to the employment contract. This can obviously have serious impacts for both the company and its performance of business as well as for the directors, who must function in the best interest of the company and in accordance with the law.

In order to be on the safe side, it is always recommendable to make a single agreement with directors for their performance of functions pursuant to the Commercial Code. Benefits recognized by the Labor Code can then be set in this agreement as well.

It would be also very beneficial if in the future, similarly as in the Czech Republic, the possibility to perform works under both acts would be clearly recognized by Slovak law. Unfortunately, even the newly proposed amendment of the Labor Code does not deal with this issue.

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