Private Law in Eastern Europe

Edited by
CHRISTA JESSEL-HOLST,
RAINER KULMS and
ALEXANDER TRUNK

Max-Planck-Institut für ausländisches und internationales Privatrecht

Materialien zum ausländischen und internationalen Privatrecht
50

Mohr Siebeck

Materialien zum ausländischen und internationalen Privatrecht

50

Herausgegeben vom

Max-Planck-Institut für ausländisches
und internationales Privatrecht

Direktoren:

Jürgen Basedow, Holger Fleischer und Reinhard Zimmermann

Private Law in Eastern Europe

Autonomous Developments or Legal Transplants?

Edited by
Christa Jessel-Holst,
Rainer Kulms and
Alexander Trunk

Mohr Siebeck

Christa Jessel-Holst is Senior Research Fellow at the Max Planck Institute for Comparative and International Private Law.

Rainer Kulms is Senior Research Fellow at the Max Planck Institute for Comparative and International Private Law, Privatdozent at the University of Hamburg, and Editor-in-Chief of the European Business Organization Law Review.

Alexander Trunk is Professor of Law at the University of Kiel where he holds a chair for Private Law and East European Law. He is Director of the Institute of East European Law and currently serves as Dean of the Kiel Law Faculty.

e-ISBN PDF 978-3-16-151297-1
ISBN 978-3-16-150589-8
ISSN 0543-0194 (Materialien zum ausländischen und internationalen Privatrecht)

Die Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliographie; detailed bibliographic data are available on the Internet at *http://dnb.d-nb.de*.

The book was printed by Gulde-Druck in Tübingen on non-aging paper and bound by Großbuchbinderei Spinner in Ottersweier.

Printed in Germany.

Preface

More than 20 years have passed since the downfall of socialist systems in Central and Eastern Europe. To usher in stable transformation processes, utmost priority was given to the recognition of *property rights*, an indispensable requirement for free market economies. Regulators soon came to realize that the success of transformation was conditioned on a more systematic approach towards codified private law and business law. Current law studies on individual Eastern European countries fail to portray the full sway of transformation dynamics. Moreover, they do not disclose that national policy responses after 1989 are far from homogeneous. Legislative projects oscillate between 'old' socialist codifications and a distinctly autonomous approach. Some countries in Eastern Europe are committed to the *acquis communautaire*. Others do not envisage membership in the European Union. All of them have strong civil law traditions. In March 2009, the Max Planck Institute for Comparative and International Private Law and the Institute of East European Law of the University of Kiel held an international symposium in Hamburg to scrutinize transformation processes from a long-term perspective, based on multi-country comparisons. In this conference volume, international policy advisors and scholars from Eastern and South Eastern Europe (Bosnia and Herzegovina, Bulgaria, Croatia, Hungary, Poland, Romania, Russia, Serbia, Slovenia and Ukraine) assess codification processes in classic private law fields and company and capital market laws. The policy section serves as a prelude to a rigorous analysis of general civil law and property law problems. The section on company law in Eastern Europe concludes.

The editors are grateful to the Deutsche Forschungsgemeinschaft, the Robert-Bosch-Stiftung and the Belgrade office of the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) for funding the conference. Without their support, the contributors could not have studied the characteristics of autonomous developments of private law in Eastern Europe and the fate of legal transplants with such enthusiasm. This volume has benefited enormously from unfailing linguistic and editorial help from Dr. *Eugenia Kurzynsky-Singer*, *Iocasta Godlieb* and *Alexander Kroeber*. *Ingeborg Stahl* deserves special praise. Her expertise and cheerfulness were decisive in channelling the constant flow of manuscripts into a book.

Hamburg, November 2010 *Christa Jessel-Holst*, *Rainer Kulms*

Contents

Abbreviations

ABGB	Allgemeines bürgerliches Gesetzbuch (Austrian Civil Code), see also ACC or OGZ
ABOR	Act on Basic Ownership Relations
ACC	Austrian Civil Code (see also ABGB or OGZ)
ADA	Australian Development Agency
AIFM	Alternative Investment Fund Managers
AktG	Aktiengesetz (German Act on joint stock companies)
Am. J. Comp. L.	American Journal of Comparative Law
AO	Aktsionernoje obshestvo (Joint Stock Company)
AOC	Act on Obligations and Contracts
APAPS	Autoritatea pentru Privatizare și Administrarea Participațiilor Statului (Authority for the Privatization and Administration of State Participations)
Art.	Article
ARUG	Gesetz zur Umsetzung der Aktionärsrichtlinie (Law for the Implementation of the Shareholder Directive)
AVAS	Autoritatea pentru Valorificarea Activelor Statului (Authority for the State Assests Recovery)
B2B	business-to-business
B2C	business-to-consumer
BAFiN	Bundesanstalt für Finanzdienstleistungsaufsicht (German Federal Financial Supervisory Authority)
BD BiH	Brčko District of Bosnia and Herzegovina
BGB	Bürgerliches Gesetzbuch (German Civil Code), see also GCC
BGH	Bundesgerichtshof (German Federal Supreme Court)
BGN	Bulgarian Lev
BiH	Bosnia and Herzegovina
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (German Federal Ministry for Economic Cooperation and Development)
BSE	Bucharest Stock Exchange
BV	Besloten vennootschap (Limited Liability Company)
CA	Commercial Act
Cardozo J. Int'l. & Comp. L.	Cardozo Journal of International and Comparative Law
CBC-RPS	Center for Business & Corporate Law Research Paper Series
CC	Civil Code
CCC	Commercial Companies Code
CEE	Central and Eastern Europe
CEM	Control-enhancing mechanism

CEO	Chief Executive Officer
cf.	confer, compare
CFR	Common Frame of Reference
CIDA	Canadian International Development Agency
CILC	(Dutch) Center for International Legal Cooperation
CIS	Commonwealth of Independent States
CISG	United Nations Convention on Contracts for the International Sale of Goods
CNCSIS	The Romanian National Council of Scientific Research of the Superior Education
CNVM	Comisia Națională a Valorilor Mobiliare (National Securities Exchange Commission)
Com	Commission
CPA	Consumer Protection Act
CPC	Civil Procedure Code
CPLP	Community of Portuguese Language Countries
CRA	Credit Rating Agencies
DCFR	Draft Common Frame of Reference
DEZA	Direktion für Entwicklung und Zusammenarbeit (Swiss Agency for Development and Cooperation)
DFID	(British) Department for International Development
DG	Director General
EA	Enforcement Act
EBLR	European Business Law Review
EBOR	European Business Organization Law Review
EBRD	European Bank for Construction and Development
ECFR	European Council on Foreign Relations
ECGI	European Corporate Governance Institute
ECJ	European Court of Justice/Court of Justice of the European Union
ED	European Democrats
EEC	European Economic Community
EEIG	European Economic Interest Grouping
EEP	European Peoples Party
e.g.	exempli gratia (for example)
ESFS	European System of Financial Supervisors
ESRB	European Systemic Risk Board
et al.	et alii (and others)
et seq.	et sequentes (and the following)
EU	European Union
Eur. Econ. Rev.	European Economic Review
FAQs	Frequently asked questions
FBiH	Federation of Bosnia and Herzegovina
FC	Family Code
FFP	Fondul Proprietății Private (Private Ownership Funds)
FINA	Financijska agencija (Croatian Financial Agency)
FNRJ	Federativna Narodna Republika Jugoslavija (Federal People's Republic of Yugoslavija)
FPS	Fondul Proprietății de Stat (State Ownership Fund)
FSA	Financial Services Authority
FSC	Financial Supervision Commission

GAAP	Generally Accepted Accounting Principles
GATT	General Agreement on Tariffs and Trade
Ga. J. Int'l. & Comp. L.	Georgia Journal of International and Comparative Law
GCC	German Civil Code (BGB)
GD	Government Decision
GDP	Gross Domestic Product
GEO	Governmental Emergency Ordinance
GmbH	Gesellschaft mit beschränkter Haftung (German Limited Liability Corporation)
GP	General partnership
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH
GUS	Polish Central Statistical Office
HUK Law Quarterly	Quarterly for the Entire Commercial, Insolvency and Capital Market Law
i.e.	id est (that is)
ibid.	ibidem (in the place cited)
ICC	International Criminal Court
I.C.L.Q.	International Comparative Law Quarterly
IFC	International Finance Cooperation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
INSOMAR	The National Institute for Opinion Surveys and Marketing
Int'l. Encyclop. Comp. L.	International Encyclopedia of Comparative Law
IPO	Initial Public Offering
IRZ	Deutsche Stiftung für Internationale rechtliche Zusammenarbeit e.V. (German Foundation for International Legal Cooperation)
J. Comp. L.	Journal of Comparative Law
J. Econ. Lit.	Journal of Economic Literature
J. Fin.	Journal of Finance
JITE	Journal of Institutional and Theoretical Economics
J. L. Econ. & Org.	Journal of Law, Economics, and Organization
JSC	Joint Stock Company
KNF	Komisja Nadzoru Finansowego (Polish Financial Supervision Authority)
KNUiFE	Komisja Nadzoru Ubezpieczeń i Funduszy Emerytalnych (Insurance and Pension Funds)
KPWiG	Komisja Papierów Wartościowych i Giełd (The Polish Securities and Exchange Commission)
LIS	Legal Indicator Survey
LLC	Limited liability company
LLM	Master of Laws
LP	limited partnership
LRA	Land Register Act
LTP	Legal Transition Programme
Maastricht J. Eur. & Comp. L.	Maastricht Journal of European and Comparative Law
McGill L. J.	Mc Gill Law Journal

MEBO	Management Employee Buy-Out
MEP	Member of the European Parliament
Mich. L. Rev.	Michigan Law Review
MKAS	Russian Federation Chamber of Commerce and Industry
MüKo	Münchener Kommentar (cited: MüKo/author)
NATO	North Atlantic Treaty Organization
NN	Narodne Novine (Croatian Official Gazette)
No.	Number
NV	Naamloze vennootschap (Joint Stock Company)
OA	Obligations Act
OAO	Otkrytoje Aktsionernoje obshestvo (Open Joint Stock Company)
OECD	Organisation for Economic Cooperation and Development
OGZ	Opći građanski zakonik (Austrian Civil Code), see also ABGB
OJ	Official Journal
OMV	Österreichische Mineralölverwaltung (Austrian mineral oil authority)
OOO	Obshestvo ogranichennoj otvetstvennostju (Limited Liability Company)
OSCE	Organization for Security and Cooperation in Europe
OTE	Hellenic Telecommunications Organization
OZZ	Okvirni zakon o zalogama (zalozima) (Framework Law on Registered Pledges)
p./pp.	page(s)
PA	Property Act
Para.	Paragraph
PECL	Principles of European Contract Law
PILC	Private International Law Code
PLN	Polish zloty
POSA	Public Offering of Securities Act
PPP	Public Private Partnership
PPSA	Personal Property Securities Act
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
RASDAQ	Romanian Association of Securities Dealers Assisted Quotation
RCL	Romanian Company Law
RCML	Romanian Capital Market Law
Rev. L. Econ.	Revue of Law and Economics
RPA	Real Property Act
RS	Republic Srpska of Bosnia and Herzegovina
RSD	Serbian Dinar
RSFSR	Russian Soviet Federative Socialist Republic
SA	Societate pe actiuni (Joint Stock Company)
SARL	Société à Responsabilité Limitée
SAS	Société par Actions simplifiée
SBA	Small Business Act
SCE	European Cooperative Society
SDC	Swiss Development Agency
SE	Societas Europaea (European Company)
SFRJ	Socijalistička Federativna Republika Jugoslavija
SFRY	Socialist Federal Republic of Yugoslavia
SIDA	Swedish International Development Agency

SIF	Societate de Investiții Financiare (Financial Investment Company)
SKA	Spólka komandytowo-akcyjna (Kommanditgesellschaft auf Aktien)
SME	Small and medium-sized enterprises
SPE	Societas Privata Europaea (European Private Company)
SRL	Limited Liability Company
SRY	Savezna Republika Jugoslavija (Federal Republic of Yugoslavia)
SSRN	Social Science Research Network
Stanf. L. Rev.	Stanford Law Review
TEC	EC Treaty
TFEU	Treaty on the Functioning of the European Union
UCC	Uniform Commercial Code
UCITS	Undertakings for Collective Investment in Transferable Securities
ULFIS	Uniform Law on the Formation of Contracts for the International Sale of goods
ULIS	Uniform Law on International Sales
UMAG	Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
USAID	United States Agency of International Development
USD	US Dollar
USSR	Union of Soviet Socialist Republics
Va. L. Rev.	Virginia Law Review
VAT	value-added tax
Vol.	Volume
WiRo	Wirtschaft und Recht in Osteuropa
WpÜG	Wertpapiererwerbs- und Übernahmegesetz
WSE	Warsaw Stock Exchange
WTO	World Trade Organization
ZAO	Zakrytoje Aktsionernoje obshestvo (Closed Joint Stock Company)
ZOSPO	Zakon o osnovama svojinskopravnih odnosa (Law on basic property relations)
ZOVO	Zakon o vlasničkopravnim odnosima (Law on Property Relations)
ZSP	Zakon o stvarnim pravima (Law on property rights)
ZV	Zakon o vlasništvu i drugim stvarnim pravima (Law on property and other in rem rights)

Private Law in Eastern Europe

Autonomous Developments or Legal Transplants?
− Welcome Address −

When the socialist regimes in Central and Eastern Europe collapsed after 1990, a new era in the development of private law started. While it had previously been difficult in socialist countries, to identify any legal relationship as "private", *Mestmäcker* characterized the new situation as a renaissance of the civil society and its law.[1] Indeed, the new social order that was established everywhere built upon private initiative pursuing private interests, and policymakers throughout Central and Eastern Europe shared the expectation that the pursuance of private interests in a competitive environment would further the public good.

As a consequence, private law had to be re-construed or even re-written with the aim of creating a legal framework that would fit private plans and reduce the possibility of state intervention in the public interest to a minimum. In several countries the political and legal elite even considered a complete overhaul of their national private law legislation as necessary. A new wave of codification rolled ashore in countries such as Russia or the Baltic Republics; in Hungary, Poland, the Czech Republic and Slovakia codification projects have been put on track and may succeed in the years ahead.

Of course, these projects are not only driven by the turn of society towards private initiative and a market economy. It is safe to assume that regaining full independence after the breakdown of the Warsaw Pact has inspired national feelings in many countries and brought about the desire for national symbols. As we know from the enactment of the first generation of civil codes throughout the 19th century the civil code has often been considered as a symbol of national cohesion.

Other motivations that may appear more economic or technocratic have equally contributed to the continuous stream of private law legislation in

---

[1] *Ernst-Joachim Mestmäcker*, Die Wiederkehr der bürgerlichen Gesellschaft und ihres Rechts, Lecture delivered at the Annual Meeting of the Max Planck Society (Hauptversammlung der Max-Planck-Gesellschaft) in Berlin, 7 June 1991, in: Rechtshistorisches Journal 10 (1991), 177 et seq.

Central and Eastern Europe. There were indeed large gaps in the existing legislation which had to be filled. For example laws on corporate entities were either absent or outdated after 50 years of an economy driven by state enterprises. In a similar vein, there had been no need for insolvency laws in socialist times; pertinent statutes were badly needed now. While state enterprises had received their operating funds through grants received from the central government in accordance with the central economic plans, they were now under a constraint to acquire fresh money from capital markets which would grant credit in accordance with the securities provided. However, security rights whether in movable or immovable assets were largely undeveloped or nonexistent, in particular where real property was owned by the State. Similar deficits could be observed in the field of banking contracts or insurance contracts.

These are but some examples of a huge task that was very aptly captured by the term "Systemtransformation" or "transformation of systems". In fact, legal systems had to be "reinvented" or conceived anew, and this was not limited to private law but included large parts of public law and criminal law as well. Scholars from both law and economics soon realized the fundamental and comprehensive character of this task which is evidenced, inter alia, by the foundation of a Max Planck Institute on the transformation of economic systems in Jena in the mid-1990s and the organization, by the predecessors of the present directors in 1996, of a symposium on the transformation of systems in our Institute.[2]

Almost 20 years have gone by since these first efforts. The European Union has proved a great attraction for most countries in Central and Eastern Europe. In 2004 and 2007 ten countries from this region joined the European Union as new Members. European integration has inevitably affected the legal systems of these countries, in particular through the implementation of the acquis communautaire. Given the increasingly intense impact of Union law on the whole legal system of the Member States, an autonomous development of their legal systems appears unlikely, even in areas which are not directly covered by Union law. The same can be said for those countries which, without being a Member of the European Union, aspire towards membership.

This explains the overarching topic of this conference: While the countries of Central and Eastern Europe have succeeded in regaining their national independence which should be a basis for an autonomous development of law including private law, the dynamics of European integration generate practical needs and, in fact, narrow the political latitude of

---

[2] *Ulrich Drobnig/Klaus J. Hopt/Hein Kötz/Ernst-Joachim Mestmäcker*, eds., Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten, Tübingen 1998.

national legislators even in the areas still left under unrestricted national sovereignty. Moreover, several countries might prefer to follow model legislation that has proven satisfactory in Western European countries. The reception of such transplants may be a particularly promising way for small jurisdictions which have only had a few years to digest a huge mass of Union law, developed over 50 years and which Western countries have had sufficient time to adjust to.

These are the potential extremes of the development of private law in Central and Eastern Europe after 1990. The enquiry of this conference is directed to three specific areas which mirror these influences in rather different ways: While company law has been subject to EU influence to a large extent ever since the 1960s, the impact of Union law in the field of contracts has been more recent and much more limited, namely to consumer contracts; the restrictions imposed by Union law are probably least significant in the field of property, where consequently, we may expect a more distinct national character of the law to be generated by autonomous developments. Before we approach the more specific areas of the law, some more general and theoretical analysis will prepare the terrain for specific enquiries.

From the list of speakers at this conference, significant differences emerge concerning their nationality. While all of them represent countries which adhered to doctrines of socialist law before 1990, some of them originate in countries which are now Member States of the European Union, others are nationals of candidate countries, and a third group is from countries which for the foreseeable future will be good neighbours, but not Members. This composition of our guests promises some insights into the variety of legal solutions and their embeddedness in the respective legal systems as well. Let me conclude by wishing you a warm welcome to the Max Planck Institute and to wish all of us an interesting conference.

Jürgen Basedow

A. Perspectives of Civil Law in Eastern Europe
Policy Issues

Optimistic Normativism after Two Decades of Legal Transplants and Autonomous Developments

RAINER KULMS

I. Origins of a Conference

When *Ajani* assessed the transformation processes in Russia and Eastern Europe in 1995, he noted a strong sense of 'optimistic normativism'. Law had come to be seen as an instrument of social engineering, indispensable for the creation of a free market[1]. The European Union shared this normative approach[2]: The Commission's 'White Paper on the Preparation of Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union' urges associated countries to adopt internal market legislation and to establish structures to support the economic reform process[3]. The EU's Copenhagen criteria require a new Member

[1] *Ajani*, By Chance and Prestige: Legal Transplants in Russia and Eastern Europe, Am. J. Comp. L. 43 (1995), 93 (103); cf. *id.*, Law and Economic Reform in Eastern Europe – The Transition from Plan to Market during the Formative Years of 1989 – 1994, in: Buxbaum/Mádl (eds.), State and Economy, Int'l. Encyclop. Comp. L. Vol. XVII, Ch. 3 (2006).

[2] Cf. *Ajani*, Transfer of Legal Systems from the Point of View of the "Export Countries", in: Drobnig/Hopt/Kötz/Mestmäcker, Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten (Beiträge zum ausländischen und internationalen Privatrecht 64 (1998)), 39 (51 et seq.); and *Mádl*, State and Economy in Transformation – Revolution by Law in the Central and Eastern European Countries, in: Buxbaum/Mádl (eds.), State and Economy, Int'l. Encyclop. Comp. L. Vol. XVII, Ch. 2 (2000).

[3] COM(95) 163final, Brussels 3 May 1995.

State to maintain political stability (including institutions guaranteeing democracy and the rule of law) and to accept the Community *acquis*[4].

Two decades after the end of socialist law, legal transplants are commonplace for comparative lawyers who reflect on the trajectory of legal and economic change in transformation countries[5]. Closer inspection suggests that private law developments in Eastern Europe are more complex, going well beyond the mere observance of non-domestic blueprints[6]. By ignoring the institutional peculiarities of the 'importing' country, standardised legal transplants and harmonisation schemes have become unduly rigid[7]. After a sobering experience in privatizing state-owned enterprises *Black/Kraakman/Tarrassova* acknowledged that endogenously developed traditions matter more than the most sophisticated privatisation schemes: Hayek had triumphed over Coase[8]. Governments should focus on building institutions to "control self-dealing and to support a complex market economy"[9]. Although this does not deny the analytical value of econometrics and models measuring efficiency[10], institutional and political economy

---

[4] European Union Press Release of 22 June 1993 (DOC/93/3), European Council in Copenhagen 21–22 June 1993, Conclusions of the Presidency <http://europa.eu/rapid/pressReleasesAction.do?reference=DOC/93/3&format=HTML&aged=1&language=EN&guiLanguage=en).

[5] Cf. *Pistor/Keinan/Kleinheisterkamp/West*, Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries, The World Bank Research Observer 18 (1) (2003), 89 et seq., and country studies in: Welser (ed.), Privatrechtsentwicklung in Zentral- und Osteuropa, Veröffentlichungen der Forschungsstelle für Europäische Rechtsentwicklung und Privatrechtsreform an der Rechtswissenschaftlichen Fakultät der Universität Wien 1 (2008). For a spirited criticism of legal transplants see *Legrand*, The Impossibility of 'Legal Transplants', Maastricht J. Eur. & Comp. L. 4 (1997), 111 (113 et seq.).

[6] Cf. *Graziadei*, Legal Transplants and the Frontiers of Legal Knowledge, Theoretical Inquiries in Law 10 (2009), 723 (727 et seq.); *Michaels*, Comparative Law by Numbers? – Legal Origins, Doing Business Reports, and the Silence of Traditional Comparative Law, Am. J. Comp. L. 57 (2009), 765 et seq.

[7] See *Milhaupt/Pistor*, Law & Capitalism – What Corporate Crises Reveal about Legal Systems and Economic Development around the World (2008), 20 et seq., 197 et seq., warning that over-attachment to a simplified evolutionary model of legal change may taint law reform efforts, including legal transplant and legal harmonisation projects pursued by the European Union.

[8] *Black/Kraakman/Tarrassova*, Russian Privatization and Corporate Governance: What Went Wrong?, Stanf. L. Rev. 52 (2000), 1731 (at p. 1802). Cf. *Roggemann/Lowitzsch*, Privatisierungsinstitutionen in Mittel- und Osteuropa (2002), 62 et seq., on statutory privatisation schemes in Central and Eastern Europe.

[9] *Ibid.* For a political science analysis of East European transformation processes: *Merkel, W.*, Systemtransformation (2nd ed. 2010), 324 et seq.

[10] Cf. *Armour/Deakin/Lele/Siems*, How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor, and Worker Protection, Am. J. Comp. L. 57 (2009), 579 (626 et seq.).

analysis is apposite to furnish meaningful answers on how legal systems evolve, shedding light on the impact of decision-making processes and pre-socialist legal traditions[11].

II. Legal Origins, the Acquis Communautaire and Notions of Efficiency

In explaining the potential of legal transplants *Watson* observed that changes in legal systems are the result of borrowing[12]. This, he declared, was true, both for the "Western world's private law of Roman Civil law and English Common law"[13]. The transfer of non-domestic concepts was unproblematic although the respective rules had not been specifically devised for the recipient society in which they then operated[14]. *Watson* does not offer a detailed explanation why lawmakers adopt foreign legal concepts when domestic laws are unable to cope with economic change[15]. Implicitly, he rejects socio-economic analysis[16]. *LaPorta/Lopez-de-Silanes/ Shleifer/Vishny* mark a radical departure from *Watson*'s approach towards legal transplants[17]: The historical origin of a country's legal rules is highly correlated with its current regulatory climate and economic outcomes[18]. *LaPorta et al.* describe common law as market-supporting whereas civil law is characterised as policy-implementing[19]. The upshot of this cate-

---

[11] Cf. *Streit/Mummert*, Grundprobleme der Systemtransformation aus institutionenökonomischer Perspektive, in: Drobnig/Hopt/Kötz/Mestmäcker (*supra* note 2), 3 (at 12 et seq.).

[12] *Watson*, Legal Transplants – An Approach to Comparative Law (1974), at p. 95: "… transplanting is, in fact, the most fertile source of development. Most changes in systems are the result of borrowing".

[13] *Ibid.*

[14] *Watson* (*supra* note 12), at 96: "…usually legal rules are not peculiarly devised for the particular society in which they now operate and also (…) this is not a matter for great concern".

[15] Cf. *Teubner*, Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences, MLR 61 (1998), 11 (16); *v. Hein*, Die Rezeption US-amerikanischen Gesellschaftsrechts in Deutschland (Beiträge zum ausländischen und internationalen Privatrecht 37 (2008)), 358.

[16] *v. Hein* (*supra* note 15), 355.

[17] *LaPorta/Lopez-de-Silanes/Shleifer/Vishny*, Legal Determinants of External Finance, 52 (3) (1997) J. Fin. 1131 et seq.; *LaPorta/Lopez-de-Silanes/Shleifer*, Corporate Ownership Around the World, 54 (2) (1999) J. Fin. 471 et seq. For a more recent account of their theoretical findings, see: *LaPorta/Lopez-de-Silanes/Shleifer*, The Economic Consequences of Legal Origin, J. Econ. Lit. 46 (2008), 285 et seq.

[18] *LaPorta/Lopez-de-Silanes/Shleifer* (*supra* note 17), 285 et seq.

[19] *LaPorta/Lopez-de-Silanes/Shleifer* (*supra* note 17), 285 (326).

gorisation is that the legal origin of norms translates into different forms of capitalism. The World Bank Development Reports build on this categorisation, promoting legal regimes which are tailored to support competitive markets[20]. In a 2008 article, *LaPorta et al.* defend their initial analysis, conceding that a clear case for the superiority of common law has not been established[21]. Nonetheless, they urge that legal origins theory should operate as a regulatory blueprint to discern legal and regulatory inefficiencies[22]. This does not bar 'importing countries' from borrowing from common and civil law countries, cumulatively in one codification as the case may be.

Legal transplants pose a two-fold efficiency problem. Even if they meet the efficiency criteria for market-supporting regulation, they still have to pass the reality test within the socio-economic context of the 'importing' country[23]: ultimately, the institutional arrangements in the 'importing country' will decide whether the non-domestic regulatory product is successful after adaptation to local circumstances[24]. A plea for institutional analysis in the importing country might be misunderstood as surrendering to regulatory fatigue and path dependence. Legal transplants are efficient if they support competitive market developments provided that they avoid negative transplant effects[25] and propel institutional reform[26]. The *acquis communautaire* has not been devised as a legislative agenda which discards the law and economics of regulation in applicant countries for the sake of European integration. In fact, the integrationist rhetoric of the EU

---

[20] World Bank Doing Business Report (various years), available at <www.doing business.org>.

[21] at J. Econ. Lit. 48 (2008), 285 (326).

[22] Cf. on the implications of this approach *Beck/Demirgüç-Kunt/Levine*, Law and finance: why does legal origin matter?, J. Comp. Econ. 31 (2003), 653 (654 et seq.), and *Siems*, Legal Origins: Reconciling Law & Finance and Comparative Law, McGill L. J. 52 (2007), 55 (62 et seq.).

[23] *v. Hein* (*supra* note 15); *Berkowitz/Pistor/Richard*, The Transplant Effect, Am. J. Comp. L. 51 (2003), 163 (179); *Waelde/Gunderson*, Legislative Reform in Transition Countries: Western Transplants – A Short-Cut to Social Market Economy Status?, I.C.L.Q. 43 (1994), 347 (371).

[24] *Berkowitz/Pistor/Richard* (*supra* note 23), 163 (190); cf. on 'assimilation' mechanisms which include legal hybrids: *v. Hein* (*supra* note 15), 369; *Dunning/Pop-Eleches*, From Transplants to Legal Hybrids: Exploring Institutional Pathways to Growth, Studies in Comparative International Developments, 38 (Winter 2004), 3 et seq.

[25] Cf. *Berkowitz/Pistor/Richard* (*supra* note 23), 163 (179 et seq.).

[26] Cf. *Radziwill/Smietanka*, EU's Eastern Neighbours: Institutional Harmonisation and Potential Growth Bonus, Centre for Social and Economic Research, CASE Network Studies & Analyses No. 386/2009 (Warsaw, 2009), 16 et seq., on extending econometric analysis beyond economic liberalisation (i.e. first-stage reforms) in order to evaluate the progress of institutional reforms (i.e. second-stage reforms). As a corollary, policy makers and scholars will have to develop new criteria for measuring the efficiency of legal transplants and transformation processes.

cannot obscure the fact that the *acquis* is also informed by the regulatory technique of legal origins and their influential proponents[27]. Nonetheless, the *acquis* adds a cooperative element to the legal origins hypothesis. Common rules induce candidates for EU membership to make *ex ante* investments to reduce switching costs[28]. Thus, an assessment of law reform in an applicant state will have to weigh the results of traditional efficiency analysis against the benefits of cooperative behaviour under the European harmonisation game. Conversely, countries may be incentivised to raise the price for cooperative behaviour (i.e. the switching costs) once they have joined the European Union[29]. As a corollary, candidates for EU membership will have to assess their switching costs in the face of regulatory competition between Anglo-Saxon (common law) concepts and civil law principles.

III. Whither Private Law in Eastern Europe?

In retrospect, the World Bank's legal origins hypothesis and the EU's *acquis communautaire* have operated as powerful political incentives to accelerate legal reform. 'Outside anchors' can relieve *ex ante* and *ex post* constraints for domestic reformers.[30]. But it is by no means a foregone conclusion that legal transplants recommended by outside institutions will automatically influence economic behaviour[31]. The peculiarities of national decision-making processes will persist and the menu of legal mechanisms implementing change is likely to vary from country to country. Thus, practitioners from 'outside anchor' institutions invariably emphasise the need to cooperate with local regulators[32].

This volume covers the countries committed to the *acquis communautaire* and others not envisaging membership in the European Union. All of

---

[27] For an assessment of the EU's regulatory technique *Pistor/Raiser/Gelfer*, Law and finance in transition countries, Economics of Transition 8 (2) (2000), 325 (340 et seq.); passim *Siems*, The End of Comparative Law, J. Comp. L. 2 (2007), 133 (144).

[28] *Carbonara/Parisi*, The paradox of legal harmonization, Public Choice 132 (2007), 367 (372).

[29] Cf. *Carbonara/*Parisi (previous note), 367 (372).

[30] *Berglöf/Roland*, The EU as an 'Outside Anchor' for Transition Reforms, Stockholm School of Economics, SITE Working Paper No. 132 (October 1997); cf. on the role of 'outside anchors' from the perspective of a recipient country: *Chanturia*, Recht und Transformation – Rechtliche Probleme aus der Sicht eines rezipierenden Landes, RabelsZ 72 (2008), 115 (119 et seq.).

[31] *Pistor/Raiser/Gelfer* (*supra* note 27), 325 (340 et seq.).

[32] See the reports in the policy section of this volume, *infra*, and *Chanturia* (*supra* note 30), 115 (120 et seq.).

them have strong civil law traditions. The contributors present introductory surveys over their respective countries' private law systems and traditions before proceeding to a detailed analysis of general private, property and company law issues. Pre-socialist codifications are relevant considerations as they establish legislative preferences in the context of the legal origins hypothesis and its economics, as do the different influences of legal transplants and autonomous developments. As the contributions to this volume demonstrate, the idea of codification is alive and well in Eastern Europe. Codifications are informed by free-market economy thinking although there is evidence that a long-term impact assessment is crucial. It is not only a matter of statutory statistics whether codifications prefer mandatory rules over extensive private ordering[33]. A substantial number of default rules may also reflect a deliberate policy decision by a national legislator.

Enforcement problems have been observed during transition periods as the judiciary, *inter alia*, experiences difficulties in coping with new legislative concepts[34]. Thus informal mechanisms and private ordering may in fact fill some gaps and permit markets to function where judicial intervention is difficult to obtain[35]. From the perspective of regulatory policy, it is, however, decisive to distinguish between private ordering which 'opts out' of the legal system voluntarily and 'forced opt-outs' due to severe enforcement problems[36]. This is not just a legislative device for contract and property law problems, it is also employed for regulating corporate governance and capital market issues[37].

Corporate governance and capital market regulation relies on a complex network of mandatory law, voluntary codes of conduct and regulation through shareholder litigation. In fact, observance of the codes of conduct marks a voluntary acceptance of industry standards. It evidences a volun-

---

[33] Cf. *Posner*, Creating a Legal Framework for Economic Development, The World Bank Research Observer 13 (1) (1998), 1 et seq., making a plea for a system of relatively precise legal rules, as distinct from more open-ended standards or heavy investment in training the judiciary.

[34] For a study on the determinants of trust against the background of court and reputational enforcement in transition countries: *Raiser/Rousso/Steves/Teksoz*, Trust in Transition: Cross-Country and Firm Evidence, J. L. Econ. & Org. 24 (2008), 407 (416 et seq.), using data from the World Bank and the European Bank for Reconstruction and Development.

[35] *Trebilcock/Leng*, The Role of Contract Law and Enforcement in Economic Development, Va. L. Rev. 92 (2006), 1517 (1546 et seq.); cf. *Hay/Shleifer/Vishny*, Privatization in transition economies – Toward a theory of legal reform, Eur. Econ. Rev. 40 (1996), 559 (560 et seq.).

[36] *Trebilcock/Leng* (previous note), 1517 (1547); cf. *McMillan/Woodruff*, Private Order Under Dysfunctional Public Order, Mich. L. Rev. 98 (2000), 2421 (2435 et seq.).

[37] See the studies in: Fox/Heller (eds.), Corporate Governance Lessons from Transition Economy Reform (2006).

tary opt-out of the legal system in as far as there are no immediate legal sanctions for not observing industry codes, which are condoned by statutory law. In a way, company law and capital market issues tend to exemplify regulatory aspirations and inefficiencies during the transition period of transformation countries. Moreover, the ownership structure of companies translates directly into legal and measurement problems as the quest for mature competitive markets continues.

The quandary regulators and policy-makers face in transition countries cannot be explained away by emphasising the influence of 'outside anchors'. Legislators have to accommodate non-domestic concepts in an environment which experiences problems of assimilation and perhaps (dis-) orientation. Once transformation counties have come to master immediate codification challenges, more attention will be devoted to evolutionary processes and enforcement mechanisms[38]. Positivist judges play a role different from those of their colleagues who accept the challenge of making an innovative codification or legal transplants work in a new institutional framework[39]. But this is not just an issue of improving judicial training. In fact, both, the *acquis* countries and those staying away from the European Union should be supplied with an analytical framework scrutinising institutional change and public choice problems[40] (including regulatory capture). The focus on the institutional context of law reform should also usher in a debate under what circumstances transplant law is inferior to domestic law-making[41]. In this context, numerical comparative law may be necessary to explore the long-term implications of legal transplants and autonomous law developments, including econometric analysis and empirical evidence[42].

The contributors to this volume present a fascinating kaleidoscope of insights into law reform processes in Eastern Europe. They have also been able to refine the notion of Euro-centrism by adding a specific Eastern European perspective. Moreover; they converted the conference into a fo-

---

[38] The quality of contract enforcement is not conditioned by the legal origin of a country's rules on civil procedure: *Spamann*, Legal Origin, Civil Procedure, and the Quality of Contract Enforcement, JITE 166 (2010), 149 et seq.

[39] In this context, an exchange of views between regulators, practitioners and academia would be an asset.

[40] See *Radziwill/Smietanka* (*supra* note 26); and *Smits*, The Harmonisation of Private Law in Europe, Ga. J. Int'l. & Comp. L. 31 (2002), 79 et seq., emphasising the need to scrutinise the processes of legal change.

[41] Cf. *Grajzl/Grajzl-Dimitrova*, The Choice in the Law-Making Process: Legal Transplants vs. Indigenous Law, Rev. L. & Econ. 5 (1) (2009), 615 et seq.

[42] Cf. *Reitz*, Legal Origins, Comparative Law and Political Economy, Am. J. Comp. L. 57 (2009), 847 (851 et seq.), and *Siems*, Numerical Comparative Law: Do we need statistical evidence?, Cardozo J. Int'l. & Comp. L. 13 (2005), 521 et seq.

rum where Eastern Europeans, by talking to other Eastern European scholars, discovered many similarities and disparities in their transformation processes. This is a significant autonomous development which deserves a warm welcome even by the most ardent supporters of the legal origins hypothesis.

Promoting Legal Reform in Eastern Europe: the EBRD Approach

MICHEL NUSSBAUMER and FREDERIQUE DAHAN*

Since its creation in 1991, the European Bank for Reconstruction and Development (EBRD) has been promoting commercial law reform in the countries of Central and Eastern Europe undertaking the transition from state-controlled economy to market economy, with a strong focus on private sector development and access to credit. The Bank aims to encourage development of the legal rules, institutions and culture on which a vibrant market-oriented economy depends. This article focuses on EBRD efforts in setting standards and assessing reform progress, which, the authors argue, are very efficient tools to promote reforms in the region. The article shows how, over the past fifteen years, EBRD legal assessments have been evolving, experimenting with new approaches and methodologies, guided by these economic objectives.

---

* This article reflects the individual opinions of the authors and does not necessarily represent the views of the EBRD.

I. Introduction

There is a good deal of misconception around legal reform, and myths surrounding the concept abound. Some see it as a 'big bang' that governments sometimes undertake (think: Napoleonic Code of 1804 in France which went on to fundamentally change the face of the country and those jurisdictions influenced by it). Others think of it as a standard political process that goes on in a rather mundane and peaceful fashion. Still others view it as the sterile and misguided course led by lawyers isolated from the real world and whose choices will go on to haunt market players for decades to come. Where legal reform is associated with developmental aid, the negative perception is usually intensified as the wholesale import of concepts foreign to the recipient jurisdiction, that usually results in undue influence and conflicts of interest, and may give rise to accusations of 'colonialism'.[1] The practice of 'legal transplantation' is often associated with the failure of aid programmes in the 1970s and 1980s.[2]

The fact is that those who are directly involved in legal reform rarely take the floor to give an account of their actions, motivations and methods.[3] This may be changing, possibly due to the increasing prominence given to

---

[1] Kahn-Freund, Otto (1974) 'On the Uses and Misuses of Comparative Law', 37 *Modern Law Review*, 1–27; Watson, Alan (1993) *Legal Transplants: An Approach to Comparative Law,* 2nd ed.*,* University of Georgia Press: Athens, Georgia; Ajani, Gianmaria (1995) 'By Chance and Prestige: Legal Transplants in Russia and Eastern Europe', 43 *American Journal of Comparative Law*, 93–99; Legrand, Pierre (1997), 'The Impossibility of "Legal Transplants"', 4 *Maastricht Journal of European Comparative Law*, 111–119; Waelde, Thomas W., Gunderson, James L. (1994) 'Legislative Reform in Transition Economies: Western Transplants – A Short-Cut to Social Market Economy Status', 43 *International and Comparative Law Quarterly,* 345. For a good overview of the issues and biography, see Gillespie, John (2006) *Transplanting Commercial Law Reform – Developing a 'Rule of Law' in Vietnam*, pp. 1–16 Ashgate: Farnham.

[2] Seidman, Ann and Seidman, Robert B. (1996) 'Drafting Legislation for Development: Lessons from a Chinese Project', 44 *American Journal of Comparative Law*, 1, esp. at 26; Seidman, Robert B. (1978) *The state, law and development* London: Croom Helm; Seidman, Ann and Seidman, Robert B. (1994) *State and law in the development process: problem solving and institutional change in the Third World* Macmillan: Basingstoke; Dahan, Frederique, McCormack, Gerard (2002) 'International Influences and the Polish Law on Secured Transactions: Harmonisation, Unification or What?/, *Uniform Law Review* Vol. VII 713–736; Dahan, Frederique (2000) 'Law Reform in Central and Eastern Europe: The Transplantation of Secured Transactions Laws', 2 *European Journal of Law Reform*, 369–384.

[3] But see for example, Dahan, Frederique, Dine, Janet (2003) 'Transplantation for transition – discussion on a concept around Russian reform of the law on reorganization', *Legal Studies*, 23(2), 284–310.

the subject of legal reform in the economic sphere over the past ten years.[4] This has enlarged the circle of those who, on the one hand, are interested in understanding the process and, on the other, are entrusted with the review of the effect and impact that law reforms may have had as against the initial objectives. Lawyers, and most importantly policy-makers, economists, and investors, are progressively expressing a direct interest in the effects of law reform. This is good news for those funding international technical assistance programmes, be they bilateral donors or the shareholders of multi-lateral international organizations, who have been increasingly calling for more detailed impact evaluations of these programmes. This too is leading to more scrutiny of legal technical assistance.

Since its foundation in 1991, the European Bank for Reconstruction and Development (the "EBRD") has sought to ensure that as much as possible is learned from the process of 'transition', a process which is in many ways, a truly unique microcosm. The EBRD is an international financial institution that supports projects in 30 countries from central Europe to central Asia.[5] Investing primarily in private sector clients whose needs cannot be fully met by the market, the Bank promotes entrepreneurship and fosters transition towards open and democratic market economies. Possibly because it was a new organization created in the aftermath of historical events, it has always held strong beliefs regarding the significance of law reform:[6]

- Law directly impacts on a market economy, so transition from a command (i.e. planned) economy to capitalism must include significant legal reform. At the same time, meeting the economic objectives of the reform is paramount. As a future user of the new system, the EBRD's focus has, from the very outset, been fixed on results, not on form. Moreover, the Bank has always been very sensitive to the fact that transition countries have different legal traditions and styles and acknowledging the importance of ensuring that new laws fit into the existing framework.

---

[4] See for instance the *Doing Business* Reports, World Bank, 2004–2009 which emphasize the importance of laws and regulations.

[5] The Bank is currently operating in: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Estonia, FYR Macedonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Mongolia, Montenegro, Poland, Romania, Russia, Serbia, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan. Note that the Czech Republic 'graduated' from EBRD operations in 2007.

[6] The points below derive mainly from the professional experience of EBRD staff working on the Bank's Legal Transition Programme.

- Adopting a regional approach may have a multiplying effect when applied in a given country, which is both efficient in terms of resources (which are always scarce) and fair as providing technical assistance to individual countries is not always possible.
- The EBRD only provides technical assistance to countries that are willing and ready to develop their own legal framework. The EBRD has little leverage power over government programmes[7] as its clients are primarily private commercial sector players, not the state in its government capacity.
- The EBRD also believes that local stakeholders are best placed to ascertain how economic objectives can be reached within their own jurisdictions and that assistance-providers should always refrain from leading the reform. Hence the importance of a consensus building exercise preceding any reform. The Bank always endeavours to foster stakeholder support for the proposed changes.
- Generally speaking, crude implants of foreign solutions into the recipient country must be firmly resisted. Where the EBRD's assistance can make an important difference is by bringing support and expertise to the process of working towards viable results (particularly in economic terms) and reducing obstacles to implementation.
- The Bank has always adopted a holistic approach to legal reform: drafting legal provisions ('black letter of the law') is only a small part of the reform process. 'Institution building' work is just as important in achieving the desired objectives and also needs to be encouraged. This may include helping establish the necessary institutions (e.g. registries), or informing and training stakeholders.

This article's objective is to outline how the EBRD has applied these principles in its legal reform programme over the last two decades. The Bank usually promotes legal reform through various activities: firstly, through participating in the establishment of internationally recognised standards or best practices for commercial and financial legislation, secondly, assessing legal regimes in transition countries against these standards and making recommendations for future reforms, and thirdly, offering technical assistance to individual governments to implement these reforms (for more information and practical examples see the numerous technical assistance projects that the Bank has carried out in transition countries[8]). While country-specific projects generate a good deal of understanding of the law reform process and, where successful, these experiences can be

[7] But the Bank can and has worked with other international financial institutions like the World Bank, which may in some instances have leverage.

[8] Comprehensive information on EBRD technical assistance projects in transition countries can be found at <www.ebrd.com/law>.

disseminated as examples of what a country can achieve, this article will primarily focus on the first two activities (standard setting and assessment), as they aim to develop the tools for law reform promotion and predetermine the whole approach to legal developmental work. More specifically, it will argue that surveys and assessments, if they are conducted in an objective, fair, and balanced fashion, can be the most effective tool for promoting legal reform. We will present the EBRD approach to this subject and how it has evolved over the years, and conclude with a few remarks on the current work agenda and prospects for the future.

II. The EBRD Legal Transition Programme

Since its foundation in 1991, the EBRD has played a unique role for an international financial institution: fostering transition to a market economy through project financing, primarily in the private sector, through careful identification of projects to expand and improve markets, by helping to build the institutions necessary for underpinning the market economy, and demonstrating and promoting market-oriented skills and sound business practices. The sudden and total collapse of the Soviet Union convinced founding countries of the urgency of providing support to a region emerging from decades of political and economic dictatorship. It became clear that boosting the role of the private sector was the linchpin for free and open market economies and crucial to the democratic transition process.

1. Why a legal transition programme?

The process of transition from planned economies to open market economies requires an enormous range of structural transformation. From very early on the EBRD became heavily involved in many areas, including banking system reform, price liberalisation, privatisation (legalisation and policy dialogue) and the creation of appropriate legal frameworks for property rights. The Bank's expertise became well-known for fostering competition throughout the economy, making the necessary changes in managerial behaviour and the establishment of commercial laws and accounting systems.

The countries of the region, at their own individual pace, undertook a radical revision of their legislation to allow for the development of modern market economies. These undertakings often resulted in successes, although, also in some failures.[9] The EBRD has regularly taken on the role

[9] See Taylor, John L., April, François, (1997), 'Fostering Investment Law in Transitional Economies: A Case for Refocusing Institutional Reform', *The Parker School Journal of East European Law,* 4 (1) 1–52.

of observer, participant or moderator in various investments or technical assistance undertakings. The EBRD's Legal Transition Programme ("LTP" or the "Programme") is therefore based on the views and concerns of the private investment community, making assistance measures both credible and practical. The Programme focuses on developing legal rules and establishing legal institutions, as well as nurturing the necessary culture for a vibrant market-oriented economy.[10] The Programme is organized thematically and has grown over the years, focusing on areas that are deemed to be of particular importance to the investment climate. These areas currently are:

- Corporate governance
- Concessions and public-private partnerships
- Judicial capacity and contract enforcement
- Infrastructure regulation and competition
- Insolvency (bankruptcy)
- Public procurement
- Secured transactions
- Securities markets

The proposed thematic approach requires a highly specialised team – the LTP uses a specialist lawyer for each of the above areas. The LTP is centralised within the EBRD Office of the General Counsel, which ensures full consistency for all legal reform activities undertaken by the Bank.

How best to deliver technical assistance was of course the key question for EBRD counsel who started working on transactions.[11] At the first Annual Meeting of the EBRD – in Budapest in April 1992 – the EBRD Office of the General Counsel led a roundtable discussion on economic law reform which had as its chosen topic 'creditors' rights and secured transactions in central and eastern Europe'. The choice of topic recognised the potential role of securities in easing the chronic shortage of credit in the former communist countries. Lenders needed assurance that they would get their money back and this assurance was hard to find in countries where would-be borrowers had no credit experience. A legal system that enables recovery from assets of the borrower could provide a solution which would not only increase the availability of credit, but also improve the terms attached to it, notably the duration and the cost. One of the outcomes of the roundtable discussion was a request made by three eminent lawyers from

[10] Bernstein, D. (2002) 'Process drives success: Key lessons from a decade of legal reform', *Law in transition*, Autumn 2002, EBRD 2–13.

[11] Simpson, John and Menze, Joachim (2000) 'Ten years of secured transactions reform', *Law in transition*, Autumn 2000, EBRD 20–27.

central Europe[12] that the EBRD propose a basis for uniform or similar regulation of secured transactions across the region. The purpose was clear: to lead the way to reform by concrete and practical example, that was distinct and not influenced by other individual systems.

2. The EBRD Model Law and Other Standards: Principles and Role

a) The EBRD Model Law on Secured Transactions

The EBRD embarked on the preparation of its Model Law on Secured Transactions which was published in April 1994.[13] It was stressed from the outset that the Model Law is not intended as detailed legislation for direct incorporation into local legal systems. It is, however, intended to form a basis from which national legislation for transition countries could be developed, to act as a starting point, indicating through a detailed legal text how the principal components of a law for secured transactions could be drafted, whilst allowing for a high degree of flexibility for adaptation into local circumstances and to be a reference point which can be turned to for guidance and illustration.

The need for a model that could be used as an example was greater in the case of secured transactions than for many other areas of law. Apart from the United States and some countries that have followed the US example, there are few countries in the world that have a coherent, comprehensive and effective legal framework for a non-possessory security over movable property. In the rest of the world, the absence of a similar framework has left a gap which has been filled by an array of laws and practices built up over decades, even centuries, often providing different rules for different kinds of assets, sometimes satisfactory, sometimes not. These may enable the astute practitioner to acquire security, but at the same time they impose a substantial economic inefficiency on secured credit markets for example, by increasing transaction costs, or giving only a limited assurance of the right to obtain repayment from the assets given as security. These laws and practices certainly do not provide a suitable template for transition countries to follow. Even Article 9 of the U.S. Uniform Commercial Code (which in effect is a long chapter comprising seven sections of very detailed provisions) is not easily adaptable for other countries, particularly those where the law is based on civil law tradition, and those

---

[12] Professor Dr Attila Harmathy of Hungary, Professor Peter Sarcevic of Croatia and Professor Stanislaw Soltysinski of Poland.

[13] The Model Law on Secured Transactions, EBRD, 1994, see also <www.ebrd.com/st>.

that are far from being accustomed to the sophistication of advanced market economy practice.[14]

One principle that guided the drafting of the Model Law was the production of a text that was compatible with civil law concepts and at the same time drew on common law systems, which have developed many useful solutions to accommodate modern financing techniques. It was by deliberate design that the Model Law was prepared by both a civil and a common law lawyer.[15] In addition, the drafters were assisted by an international advisory board comprising 20 eminent lawyers from 15 different jurisdictions[16] which enabled them to draw on the experience of many countries with widely varying legal systems. Another guiding principle was that the Model Law had to be simple in order to be of practical use for economies in transition. It sought to illustrate a basic system on which more sophisticated rules could be developed.

The EBRD is often asked how many countries have adopted the Model Law. The answer has to be 'none' because it was never produced to be adopted or transplanted. But it has been referred to and used as a template for reform in virtually all of the EBRD countries of operations (whether the EBRD was involved in the reform process or not) and well beyond the region (also in Vietnam, Sri Lanka, Thailand, China and Latin America).

It is important to understand that the EBRD does not promote a particular domestic law – it does not have a European bias since it is not an EU institution – its largest shareholder is the USA and other non-European countries including Australia, Canada, Japan, Mexico, Morocco and New Zealand are also shareholders. Being a commercial investor, the EBRD is concerned with economic, social and practical considerations. It is also sensitive to the fact that the subject area – be it PPP (Public Private Partnership), insolvency law or corporate governance, is often a heavily debated concept throughout the world, including in high-income countries.

---

[14] Article 9 of the Uniform Commercial Code was the single biggest influence on the Model Law. The difficulties of using Art 9 as a model arose from its form and complexity, from its inclusive approach and from certain basic divergences in legal concepts between the United States and continental Europe (for example, regarding ownership and transfer of property).

[15] Jan-Hendrik Röver and John Simpson.

[16] Professor David E. Allan, Australia, Mr Juan F. Armesto, Spain, Professor Milan Bakes, Czech Republic, Professor Mark M. Boguslavsky, Russia, Professor Ronald CC Cuming, Canada, Professor Jan Hendrik Dalhuisen, the Netherlands, Professor Aubrey L. Diamond QC, United Kingdom, Professor Dr Ulrich Drobnig, Germany, Mr John Edwards, United Kingdom, Professor Christian Gavalda, France, Mr Marcello Gioscia, Italy, Professor Attila Harmathy, Hungary, Professor Mary E. Hiscock, Australia, Dr Jaques Périlleux, Belgium, Mr Hugh Pigott, United Kingdom, Professor Stanislaw Soltysinski, Poland, Mr Ken Tsunematsu, Japan, Mr Philip R Wood, United Kingdom, Mr John Young, USA and Dr Peter Zier, Germany.

One example of this can be found in insolvency regimes, where many fundamental issues (such as priority ranking of claims or stay of payment upon commencement of the insolvency proceedings) are debated by quite different schools of thought.

b) Other Standards Prepared by the EBRD

Rather than fitting into a pre-established mould that would be falsely presented as the definitive answer to the legal subject in question, any new legal provisions need to 1) be adapted to the national environment where they are to operate; 2) be well understood in terms of the underlying policy approach so that they can be intelligently reviewed should the choice be revisited at a later date; and 3) fit with the initial economic objectives they were meant to serve when the reform was undertaken. The EBRD standards serve precisely this role. Following the Model Law on Secured Transactions, the EBRD has prepared a number of other standards that it uses when promoting legal reforms aiming to achieve specific economic objectives. These include:

- *Core Principles for a Secured Transactions Law (1998)*[17] *and a Mortgage Law (2008)*,[18] express the fundamental requirements for a modern secured transactions law, which have been adapted to refer specifically to mortgages. The principles do not seek to impose any particular solution on a country – there may be many ways of arriving at a particular result – but they do indicate the result that should be achieved.
- *Guiding Principles for Charges Registries (2004)*[19], address the basic requirements for the development and operation of a registration system for security interests (charges) over movable property, together with guidelines for their implementation.
- *Insolvency Office Holders Principles (2007)*[20], recognize that a solid law is not enough for an effective insolvency system, and provides a set of principles to guide countries in setting standards for the qualification, appointment, conduct, supervision, and regulation of insolvency office holders (be they called trustees, administrators, liquidators, insolvency representatives, or similar functionaries).

---

[17] EBRD Core Principles for a Secured Transactions Law, available online at <www.ebrd.com/pages/sector/legal/secured/core/coreprinciples.shtml>.

[18] EBRD Core Principles for a Mortgage Law, available online at <www.ebrd.com/pages/sector/legal/secured/core/mortgagelaw.shtml>.

[19] EBRD (2004) Publicity of Security Rights; Guiding Principles for the Development of a Charges Registry, EBRD.

[20] EBRD Insolvency Office Holder Principles (2007) Available online: <www.ebrd.com/pages/sector/legal/insolvency/legal_framework.shtml> [accessed 23 July 2009].

– *Policy Brief for Corporate Governance in Banks in Eurasia (2008)*[21] was produced by a task force made up of representatives of banks, banking associations and regulators from the Eurasian region, supported by technical assistance and expertise of the EBRD and the Organization for Economic Cooperation and Development. The Policy Brief identifies key corporate governance challenges affecting banks in that region and makes recommendations to address them.

III. The EBRD Legal Assessment Work: Philosophy and Evolution

In order to implement the first tenet of quality legal reform listed above (that legal provisions are adapted to the system in which they should operate), the LTP aims to assess the legal frameworks in the key sectors EBRD is most concerned with.

The philosophy behind assessment work is of course fully consistent with the LTP approach to law reform: the main objective is to promote legal reform by making information available on key commercial law issues. This information must be useful to investors and their advisers, and give clear indications of the changes that are needed if the economic benefits are to be maximised. These assessments are then used to promote policy dialogue and reforms. Also, because the work is, to a large extent, remotely initiated and supervised (due to the centralised nature of the LTP and the fact that it covers all 30 countries where the EBRD operates), maximum impact must be achieved with limited operational and financial resources. A very effective way to build consensus on the shape of a future reform is to point to what neighbouring jurisdictions have achieved. For example, when EBRD advised the Serbian government on the development of the Law on Pledges over movable assets (ultimately adopted in 2003), it was able to refer to the Hungarian, Polish and Slovak laws and the practical solutions adopted in these countries. This requires having a host of details available.

Assessment needs to be precise, accurate and fair. A survey is to provide a uniform basis for objective comparison between all countries from Central Europe to Central Asia by highlighting the strengths and weaknesses of the legal framework in each country. It is difficult for a country

[21] Corporate Governance of Banks in Eurasia: A Policy Brief (2008) OECD and EBRD, available online: <www.ebrd.com/downloads/legal/corporate/policyen.pdf> [accessed 23 July 2009] The countries of Eurasia are Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Ukraine and Uzbekistan.

to understand its own position in isolation or even by comparison with the laws and practices of countries in Western Europe and North America. Comparison with other transition countries can give a more meaningful indication of the degree of improvement that has been made and can also encourage mutual assistance between transition countries where each can learn from the other and where the benefits of progress can be readily transferred.

Over the years, the LTP has developed various assessment tools, constantly fine-tuning its analysis and methodologies, a reflection of its own evolving understanding of law reform.

1. Legal Indicator Surveys (1995–2002)

As early as 1994, the EBRD Office of the General Counsel endeavoured to provide an overview of the status of legal framework in EBRD countries of operations.[22] The EBRD Legal Indicator Survey (LIS) was initiated in 1995.[23] The LIS was a survey instrument that reported how lawyers in transition economies perceived the development of new legal rules and whether they felt, according to their experience, that these rules were being implemented effectively. The LIS was published in the EBRD's annual Transition Report, which gave a detailed account of progress made by countries in the region going through the transition process. The LIS was the very first attempt to gauge the impact of the formidable changes that were occurring in the region's legal frameworks, and it exposed important lessons to be learned – in particular the widening 'implementation gap' created by hastily adopted legislation with little understanding of its true significance and without adequate means for implementation.[24] While local perceptions were of course of great interest, as the transition process to a large extent was about changing the existing mentality, these local per-

---

[22] See EBRD Transition Report 1994, Chapter 5, 'The framework of law in transition', 69–77.

[23] LIS results were published in the Bank's Transition Reports between 1995 and 2002. See in particular EBRD Transition Report 1995, Chapter 6, 'The contribution of law to fostering investment', 101–108.

[24] Ramasastry, Anita, Styliadou, Meni and Slavova, Stefka (1998), 'Market perceptions of telecoms reform – survey results', *Law in transition*, Autumn 1998, EBRD 30–37; Ramasatry, Anita, Slavova, Stefka (1999) 'Market perceptions of financial laws in the region – EBRD survey results', *Law in transition*, Spring 1999, EBRD 24–34; Ramasatry, Anita, Slavova, Stefka (1999) 'Market perceptions corporate governance – EBRD survey results', *Law in transition*, Autumn 1999, EBRD 32–29; Ramasatry, Anita, Slavova, Stefka (2000) 'EBRD legal indicator survey: assessing insolvency laws after ten years of transition', *Law in transition*, Spring 2000, EBRD 34–42; Ramasastry, Anita (2002) 'What local lawyers think: A retrospective on the EBRD's Legal Indicator Surveys', *Law in transition*, Autumn 2002, EBRD 14–30.

ceptions could not by themselves be the yardstick that transition countries needed to define their reform programme. As legal reform work intensified at the EBRD, the need for a tool to reflect both the achievements and the challenges ahead became acute.

2. Secured Transactions Regional Survey and other Legal Sector Assessments (1999 to present)

The first attempt to provide a comprehensive comparative assessment of laws and practices in the region was provided by the *Secured Transactions Regional Survey*, first published in 1999 and regularly updated thereafter.[25] This is a tabular analysis of current secured transactions law and practice in 30 countries. The Survey covers consensual non-possessory pledges over movable (including intangible) property. The primary aim of the Survey is to provide an accessible and user-friendly overview of the relevant laws in each country in the region. Inevitably, the information provided is of a summary nature: the questions address the principal issues and give preliminary answers to basic, practical questions which a practitioner needs to know: the rules governing the *creation* of a pledge; the extent to which the legal framework is adapted to the *needs of commercial transactions* in modern market economy; the *effect of security rights on third parties*; and finally the extent to which the legal right given by the pledge on the charged property can be *enforced* in practice. The Survey not only provides information but also enables the evaluation of legal provisions against the Secured Transactions Core Principles benchmark,[26] and encourages improvement and mutual assistance between countries of the region.

Table 1: Secured Transactions Law – A comparison of selected EBRD countries of operations

1. Key elements of a charge					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
1.1. Does the charge create a proprietary security right?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓

[25] See EBRD website on secured transactions at <www.ebrd.com/pages/sector/legal/secured.html>, the country reports at <http://www.ebrd.com/pages/sector/legal/cla.shtml> and Fairgrieve, Duncan, Andenas, Mads, (2000) 'Securing progress in collateral law reform: the EBRD's Regional Survey of secured transaction laws', *Law in transition*, Autumn 2000, EBRD, 28–35. See also Dahan, Frederique, and Simpson, John (2004) 'Secured transactions in Central and Eastern Europe: EBRD Assessment', *Uniform Commercial Code Law Review*, 36, 77–102.

[26] <www.ebrd.com/pages/sector/legal/secured.shtml>.

1.2. Can the charge be granted by any person?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
1.3. Can the charge be granted to any person?	✓✓	✓✓✓	✓✓✓	✓✓	✓✓✓
1.4. Can the charge secure any debt?	✓✓✓	✓✓	✓✓✓	✓✓	✓✓
1.5. Can the charge cover all types of asset?	✓✓	✓✓	✓✓✓	✖✖	✓✓
1.6. Does the charge give priority over all other creditors?	✓✓	✖✖	✓✓	✓✓✓	✓✓✓

2. Creation of the charge					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
2.1. Is the manner of creation of the charge clearly defined?	✓✓✓	✓✓✓	✓✓✓	✖✖	✓✓✓
2.2. Is it simple?	✓✓	✓✓✓	✓✓✓	✖✖	✓✓✓
2.3. Is it quick?	✖✖✖	✓✓✓	✓✓✓	✓✓	✓✓✓
2.4. Are charges publicised through registration?	✓✓✓	✖✖	✓✓✓	✖✖	✓✓✓
2.5. Are costs of creation low enough not to dissuade the parties involved	✓✓✓	✓✓✓	✓✓	✖✖	✓✓✓

3. Commercial effectiveness					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
3.1. Can the chargor use the charged property?	✓✓✓	✓✓✓	✓✓✓	✖✖✖	✓✓✓
3.2. Can property be described generally?	✓✓	✖✖	✓✓✓	✖✖✖	✓✓
3.3. Can a charge be given over post-acquired property?	✓✓✓	✓✓	✓✓✓	✖✖	✓✓✓
3.4. Can a charge cover a fluctuating pool of assets?	✓✓	✖✖	✓✓✓	✖✖✖	✓✓
3.5. Can the secured debt be defined generally?	✓✓✓	✖✖	✓✓✓	✓✓✓	✓✓
3.6. Can a future debt be secured?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
3.7. Can the debt be in a foreign currency?	✓✓✓	✓✓✓	✓✓✓	✖✖	✓✓✓

3. Commercial effectiveness					
3.8. Can a fluctuating pool of debt be secured?	✓✓✓	✖✖	✓✓✓	✓✓✓	✓✓
3.9. Do parties have wide flexibility to agree commercial terms?	✓✓✓	✓✓	✓✓✓	✖✖✖	✓✓✓
3.10 Are subsequent charges permitted over the same property?	✓✓✓	✓✓✓	✓✓✓	✖✖	✓✓✓

4. Effect of the security right on third parties					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
4.1. Does a charge give priority in a charged property?	✓✓	✖✖	✓✓✓	✓✓✓	✓✓✓
4.2. Does the secured creditor have priority in bankruptcy?	✓✓✓	✖✖	✓✓	✓✓✓	✓✓✓
4.3. Can a third party determine whether property is charged?	✓✓✓	✖✖✖	✓✓✓	✓✓	✓✓✓
4.4. Does a third party acquire property free from charges in the ordinary course of business?	✓✓✓	✓✓✓	✓✓✓	✖✖✖	✓✓✓
4.5 Is person acquiring in good faith and without a notice of charge, protected?	✓✓✓	✖✖✖	✓✓✓	✖✖✖	✓✓✓

5. Enforcement of the charge					
	Poland	**Russia**	**Slovak Republic**	**Turkey**	**Ukraine**
5.1. Is the manner of enforcement of charge clearly defined?	✓✓	✓✓	✓✓✓	✓✓✓	✓✓✓
5.2. Is there tried practice?	✓✓✓	✓✓	✓✓✓	✓✓✓	✓✓✓
5.3. Can the chargeholder protect assets?	✖✖	✖✖	✓✓	✓✓✓	✓✓
5.4. Can the chargeholder obtain rapid realisation?	✖✖✖	✖✖	✓✓✓	✖✖✖	✓✓✓
5.5. Can the chargeholder exercise control on the way realisation takes place?	✖✖	✖✖	✓✓✓	✖✖✖	✓✓✓

5.6. Does the enforcement procedure allow expectation of reasonable realisation proceeds after costs?	✖✖	✓✓	✓✓✓	✖✖	✓✓✓
5.7. Does commencement of enforcement have to be publicised?	✖✖✖	✖✖✖	✓✓✓	✖✖✖	✓✓✓
5.8. Is purchaser in enforcement procedure protected?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓

✓✓✓Yes ✓✓ Yes, but with reservations ✖✖✖ Categorical no ✖✖ Indicates that response is negative, but there are some mitigating factors in law or practice
Source: EBRD Regional Survey on Secured Transactions 2006–2008

It was fundamental to the design of the Survey that the assessment should be perceived as being fair, objective, and non-judgemental. It is not the EBRD's place to dictate what countries ought to do, and there is a lot of sensitivity associated with a 'league table' of countries being ranked one against the other. The Survey therefore grades each question by reflecting a gradual progression from a clear "yes" (✓✓✓) to a clear "no" (✖✖✖), with intermediary grading to reflect reservation in practice or in law or mitigating factors (see Table 1). It shows at a glance the areas which are most deficient and why, and the explanatory notes ensure a consistent approach to the questions in all countries.[27]

The Survey has been expanded to cover several related areas such as collateral (pledge) registers[28] and mortgage law[29].

Furthermore, from 2002 onwards, Legal Sector Assessments were prepared for other commercial law areas where the EBRD was actively involved, in particular corporate governance, insolvency, securities markets, and concessions. These assessments, however, differed from the Regional Survey described above as they simply benchmarked existing laws against a checklist of ingredients essential for a sound legal regime and evaluated how well these laws approximate international standards.[30] Although the Regional Survey is arguably more comprehensive as it evaluates the existing laws and their implementation and practical application, Legal Sector Assessments have proved useful as they are easy to understand, very detailed (the assessment usually comprises up to 100 questions) and convenient for policy dialogue. Sector assessments are produced by

[27] <www.ebrd.com/pages/sector/legal.shtml>.

[28] <www.ebrd.com/pages/sector/legal/shtml>.

[29] <www.ebrd.com/pages/sector/legal/secured/core/mortgagelaw.shtml>.

[30] The Bank refers to this type of analysis as showing 'extensiveness' of legislation as opposed to 'effectiveness' which is captured by other tools (e.g., new Legal Indicator Surveys).

selected experts in the field – either the EBRD's own legal transition team or external consultants, who evaluate commercial laws throughout the EBRD region of operations to ensure a higher consistency of responses than that provided by the local respondents for the LIS. Additionally, countries are no longer rated numerically; instead they are evaluated and placed in categories, depending on the degree to which various commercial laws reflect international standards and practices (see Table 2). It should be noted however that these assessments are by definition only partial and theoretical, and cannot be used as a replacement for an examination of the actual functioning of the system itself.

Table 2: Legal Sector Assessment: Level of compliance with international standards for corporate governance

Very high compliance	High compliance	Medium compliance	Low compliance	Very low compliance
0 countries	8 countries	14 countries	2 countries	6 countries
	Hungary Lithuania Czech Republic Romania Russia Slovak Republic Slovenia Turkey	Armenia Bosnia & Herzegovina Bulgaria Croatia Estonia Kazakhstan Kyrgyz Republic Latvia FYR Macedonia Moldova Mongolia Poland Serbia Uzbekistan	Albania Turkmenistan	Azerbaijan Belarus Georgia Montenegro Tajikistan Ukraine

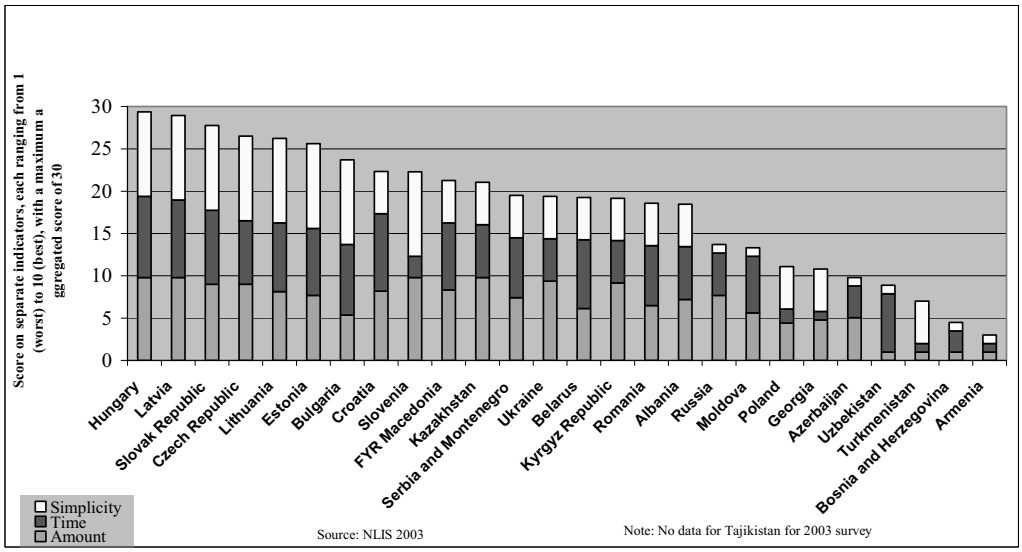
Source: EBRD Legal Sector Assessment on Corporate Governance 2007

3. New Legal Indicator Survey (2003 to date)

In 2003, the Bank launched a new Legal Indicator Survey based on a different methodology. Rather than assessing general perceptions of effectiveness, as was the case between 1995 and 2002, the EBRD decided to try and assess the effectiveness of commercial legal reform in a more reliable and verifiable manner. This assessment gauges how the law works in practice for a given scenario. A selected law firm in each of the EBRD's countries of operations is presented with a consistent and fixed set of facts concerning a hypothetical legal case and then asked to provide specific,

factual answers about how the case would be resolved in practice. As the *practical outcome* is compared, rather than a list of applicable rules, this approach allows for a more reliable comparison of law effectiveness across countries, providing less subjective responses. Moreover, expert respondents are encouraged to supply more detailed narrative responses to questions, providing a factual basis for their responses and opinions. There is thus more scope for exploring the flaws or bottlenecks which prevent the system from producing satisfactory outcomes. For the first case study in 2003, the EBRD secured transactions experts devised a case involving a secured creditor whose claim was not satisfied. The practical outcome was to predict the amount the creditor could recover, and how long it would take to enforce his security and realize the pledged assets (see Chart 1). Countries were thus evaluated based on the ability of their legal system to produce specific desirable outcomes, which were able to be quantified as much as possible ('how many pennies to the pound will the secured creditor expect to receive in case of default?').[31]

Chart 1: EBRD New Legal Indicator Survey: Enforcement of Charged Assets



Source: EBRD New Legal Indicator Survey 2003

A case study has the advantage of concentrating on the *facts* as opposed to the *rules*, and to assume a situation as close as possible to the context of

[31] Overall, EBRD assessment thus consists of both evaluation of the sector assessment for a number of key commercial law areas as well as further analysis of the law in action for the same sectors.

normal commercial practice. Using case studies to survey legal systems is a road which many organizations have recently taken, for instance the World Bank's Lex Mundi project[32] and also the Trento project on "The Common Core of European Private Law".[33] Judicious drafting of the case study is paramount to the quality of the responses: if the case is too wide, the results will not be comparable across jurisdictions; if it is too narrow, it may not leave the respondent sufficient scope to describe particularities of the legal system which may have dramatically affected the results. The approach to quantifying the impact of laws and regulations was spearheaded by the work of development economists in the last decade, such as De Soto and De La Porta et al.[34] It is best known through the World Bank Reports on *Doing Business* published since 2004, which have brought the practical importance of good regulation to the fore of the economic development theory. They followed the seminal work of Shleifer[35] on law and financial markets. Ultimately, practical results (e.g. time required to evict a tenant; or to register a business) matter just as much as the black letter of the law.

However, lawyers often feel uncomfortable with such an approach: firstly situations in reality are considerably more complex than can be incorporated into the facts of a case study. The factual assumptions of the case study must be well defined, thereby limiting the scope of the analysis, which makes the assessment results difficult to use as a proxy for the full scope of the law. Secondly, some practical aspects, such as the fairness, flexibility or certainty deriving from regulations cannot be measured, but still play an important role.[36]

For the EBRD, the response to the limitations of the New Legal Indicator Survey highlighted above was to design an assessment that focused on practical, economic outcomes being detached from the formality of the

---

[32] The Lex Mundi project, which forms part of a larger World Bank project on "Doing Business" in various jurisdictions throughout the world. See Simeon Djankov, Rafael La Porta, Florencio Lopez De Silanes, and Andrei Shleifer, 'Courts: The Lex Mundi Project (March 2002)' *Yale ICF Working Paper* No. 02-18; *Harvard Institute of Economic Research Paper* No. 1951.

[33] See <www.common-core.org/>. See also *Security Rights in Movable Property in European Private Law. The Common Core of European Private Law* (2004) Eva-Maria Kieninger (ed.), Cambridge University Press

[34] Djankov, Simeon, La Porta, Rafael, Lopez-de-Silanes, Florencio, Shleifer, Andrei (2003) 'The New Comparative Economics', *Journal of Comparative Economics* 31 (4), 595–619.

[35] Schleifer, Andrei, La Porta, Rafael, Lopez-de-Silanes, Florencio, Vishny, Robert (1998) 'Law and Finance' *Journal of Political Economy*, 106 (6), 1113–1155.

[36] See Armour, John, Deakin, Simon, Lee, Priya, and Siems, Mathias (2009) 'How do legal rules evolve? Evidence from a cross-country comparison of shareholder, creditor and worker protection', *American Journal of Comparative Law*, 57 (3), 579–630.

law, its structure and conceptual underpinning, whilst managing to grasp the complexity and interwoven nature of the law and the way it impacts on users' behaviour. This is what the following type of assessment attempts to achieve.

4. The Legal Efficiency Approach and EBRD Most Recent Assessments

a) Mortgage Law Assessment

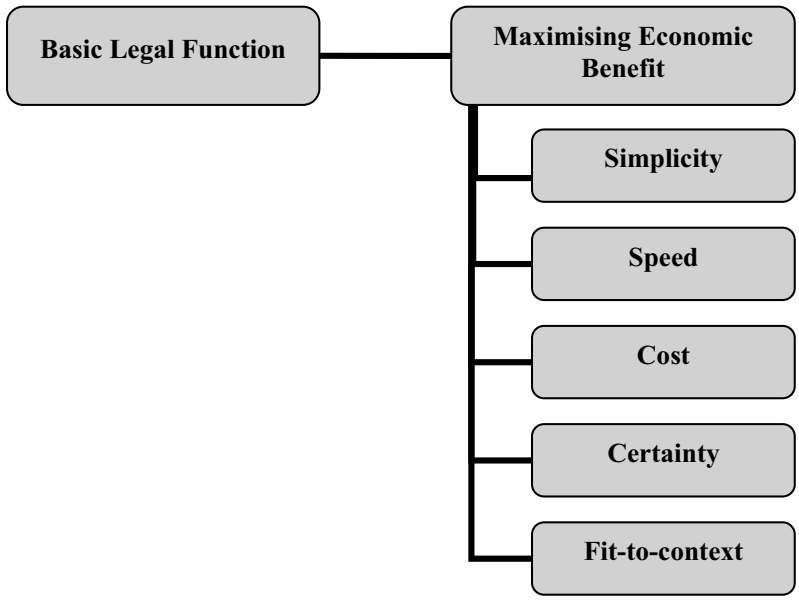
In its recent work on mortgage law and mortgage securities, the EBRD developed the concept of 'legal efficiency' as the basis for its assessment of the sector. The term 'legal efficiency'[37] is used to indicate *the extent to which a law and the way it is used fulfils the purpose for which it was designed and provides the benefits that it was intended to achieve.*

The key function of a secured transactions law is economic as the secured credit market has essentially an economic function (whilst recognising that it may also have important social function and consequences). The fact that any jurisdiction can function without a secured credit market makes it facilitative in nature. A relatively simple indicator of the success of a secured transactions law reform (or primary motive for reforming secured transactions law) is the subsequent increase in the volume of secured lending. This however is a crude and narrow indicator, and wholly inadequate by itself. The intended function of the secured credit market is more than merely to boost the amount of credit granted against security. It may also include, for example, opening up credit to new sectors of society, encouraging new housing construction, or allowing privately-funded infrastructure projects. Legal efficiency is thus analysed by looking at the degree to which the legal framework enables secured transactions, first, to achieve their basic function, and secondly, to operate in a way which maximises economic benefit. And, as shown in Table 3a, the second criterion is broken into five separate headings: simplicity, cost, speed, certainty and fit-to-context.

---

[37] Dahan, Frederique and Simpson, John (2008) 'Legal efficiency of secured transactions reform: bridging the gap between economic analysis and legal reasoning' *Secured Transactions Reform and Access to Credit,* Dahan, Frederique and Simpson, John (eds) Edward Elgar Publishing Limited, Cheltenham, pp. 122–140.

Table 3(a): Criteria for legal efficiency of secured transactions law



The basic legal function of a secured transactions law is to allow the creation of a security right over assets which, in the case of non-payment of a debt, entitles the creditor to have the assets realised and the proceeds applied to the satisfaction of his claim prior to those of other creditors. If a secured transactions law only gives the creditor a personal right but no right to the assets, or if there is no right to enforcement, or no priority vis-à-vis other creditors, the law fails to achieve its basic legal function. An absolute priority for taxes and other state claims ahead of the secured creditor, or the right in insolvency of ordinary creditors to share in a portion of the proceeds, are more than inefficiencies in the secured transactions law. They are defects which prevent it from fully achieving its basic function. They may be intentional (a super-priority of the state usually is) but they reflect a compromise between two laws with conflicting purposes. Any such compromise inevitably inhibits the effective operation of secured transactions law and introduces uncertainty into the minds of lenders.

If the legal framework for secured transactions is to operate in a way which *maximises economic benefit*, the system for creation and enforcement of pledge or mortgage should be simple, fast and inexpensive, there should be certainty as to what the law is and how it is applied, and it should function in a manner which fits to the local context.

Simplicity – Simple does not mean simplistic: it is necessary to strike a balance between simplicity and the sophistication required by the market.

In many countries complexities have developed and become entrenched over time as laws have been adapted to new circumstances, not because of the complexity of these circumstances but rather from limitations inherent in the legal system.

Speed – For most aspects of the legal process, the less time it takes the more efficient it is. There are exceptions: a notice period or a cooling off period has to be of appropriate length, but for registration of a pledge or mortgage, for example, there can only be benefits if it takes only a few minutes rather a month, and a lender who knows that enforcement of the pledge or mortgage is likely to take several years will derive less comfort from his security.

Cost – Legal costs almost inevitably have an adverse impact on the economic benefit of a transaction. Delay, complexity and uncertainty all tend to add to costs so there is a close relation with the other aspects of legal efficiency. Some costs are within the control of the parties, at least to a certain extent. Before taking legal advice on structuring a transaction the parties can assess the value of doing so. The cost of legal advice on a complicated transaction may be outweighed by the benefits, but the cost of legal advice incurred because of defects in the legal framework always reduces efficiency, as do fixed costs (for example registration, notary or court fees).

Certainty – Certainty is a critical element of any sound legal system. A grain of uncertainty in the legal position can have a pervasive and disproportionate effect. Little makes a banker more hesitant than hearing there is some doubt regarding the legal robustness of a transaction. Transparency can often strengthen certainty: for instance, easy universal access to information in the land register allows potential mortgage lenders to find out about the property and any other mortgages that may be claimed.

Fit-to-context – The 'fit to context' criterion is the most elusive but nonetheless important as it covers a number of facets. It is not enough to adopt a law which clearly and unambiguously establishes a simple, fast and inexpensive regime for pledge or mortgage security. The efficient functioning of the law will also depend on whether it is adapted to the economic, social and legal context within which it is to operate. It needs, for example:

- To respond to the economic need. Markets are constantly changing, and the law has to be able to adapt to new products, as for example when loans are proposed with flexible interest rates.
- To achieve an appropriate balance between fulfilling the economic purpose and ensuring that the effects of the reform are acceptable in context. The rights of consumers and occupiers of property to appropriate protection cannot be eliminated to suit the economic needs of the se-

cured transactions law. Rather they have to be framed in a way which enables borrowers and lenders to derive the benefits afforded by a flourishing secured credit market while at the same time ensuring the necessary protections for vulnerable parties.

Table 3(b): Legal efficiency of mortgage law in selected transition countries

	Basic Legal function	Simplicity	Speed	Cost	Certainty	Fit-to-context
Bulgaria						
Croatia						
Czech Republic						
Estonia						
Georgia						
Hungary						
Kazakhstan						
Kyrgyz Republic						
Latvia						
Lithuania						
Poland						
Romania						
Russia						
Serbia						
Slovak Republic						
Slovenia						
Ukraine						

1 very efficient | 2 efficient | 3 some inefficiency | 4 inefficient | 5 unclear

Source: EBRD Mortgages in transition economies 2007

Legal efficiency analysis has an immediate appeal because it addresses the practical results of application of law detached from the conceptual structure of the law. There is no argument possible as to whether the indices are biased in favour of a particular legal regime – the criteria are universally known. The grading system is however subject to discussion, for instance, regarding the speed of security rights enforcement and what can be considered fast in terms of security right enforcement. Agreement must also be reached as to the basic legal function of the law in question. Data collection also requires much detailed information which can only be obtained from those with first hand experience of working of the law. The results, however, show a refined picture of a given area (e.g. mortgage law; see

Table 3 (b)) and draw immediate attention to the system's practical weaknesses which should become the focus of future reform efforts in order to achieve the law's purpose and bring maximum economic benefits as opposed to merely matching international standards. This would also ensure that the policy advice conveyed to the jurisdiction under assessment is formulated in terms of impact – benefits versus costs of reform. For instance, in many countries where the creation of a mortgage is reported by users as being slow, expensive and cumbersome, the role of notaries in the process is often blamed. From the point of view of advisers who are not familiar with this profession, notaries are often perceived as not playing a useful role, being unduly expensive (especially since the profession often enjoys a monopoly and the fees are fixed by tariffs), and bureaucratic in their handling of cases. While these accusations may be well founded in absolute terms, they need to be analysed in terms of economic impact – in other words, how much of a difference to the process would it make if notaries were abolished in countries that require their involvement for the creation of a mortgage? EBRD legal efficiency analysis in 17 jurisdictions has shown that the largest stumbling block in the efficiency of the process actually came from the registration of the mortgage in the Land Register. The role of notaries differed significantly from jurisdiction to jurisdiction so their involvement could only be tackled on a jurisdiction to jurisdiction basis and not globally. Moreover, reform resources would be best spent working on modernising the Land Registers (which is happening in many countries) or, more controversially, on fundamentally amending the procedure for mortgage registration.[38]

b) Other Recent Assessment: Telecommunications Regulatory Assessment

In a different sector, but using a similar type of approach, another important piece of assessment was conducted by the EBRD on telecommunications regulations in transition countries.[39] With a similar desire to provide assessment grounded on factual and economic data, a questionnaire was designed based on standards issued by the World Trade Organization and the European Union and sent to policymakers and implementation authorities (typically the telecoms regulator) for their comments. The EBRD also interviewed a wide cross-section of stakeholders from the sector (e.g. private operators, state operators, consumers – small and large, lawyers, etc)

---

[38] Mortgages in transition economies EBRD (2007) available online: <www.ebrd.com/pubs/legal/mit.htm> [accessed 24 July 2009].

[39] *Legal Transition Programme Telecommunications Regulatory Development Comparative Assessment of the Telecommunications Sector in the Transition Economics,* EBRD (2008) available online: (In English <www.ebrd.com/pages/sector/legal/telecoms.shtml (and in Russian) <www.ebrd.com/russian/pages/sector/legal/telecoms.shtml>.

to cross-check responses. Finally, data was collected from a wide variety of sector information, both inside and outside the country including:

- Databases and other collected data (available from the EBRD, European national governments and their constituent ministries, official national data sources.
- Business Information of interest to current and prospective operators/ investors such as licensing procedures, technical requirements, interconnection agreements, online forms for certification, authorisation etc.
- Consumer and Citizen Information: Information of interest to investors, prospective investors, end-users or prospective end-users regarding consumer information, universal service, consumer rights (and abuses reporting processes) and tariffs. In addition to actual legislation and formal guidelines, digested information such as clear explanations (e.g. complaint procedure), and FAQs (frequently asked questions) on Ministry and Regulatory websites was also consulted,
- Telecom regulatory news and other news or journalistic based sources: This element included information, regulatory news and developments published or available from researchers and journalists.

The draft assessment was then sent to every authority in each country to give them a further opportunity to respond to the assessment or correct any of the data upon which it was based, further advancing the consensus on what reforms may be needed in each country.

When resources are scarce and with the agenda of reforms ever lengthening, this form of diagnosis is essential if reform is to deliver the economic benefits that are hoped for.

IV. Vision for the future

After almost 20 years of transition, the size of the legal reform challenge remains significant throughout the EBRD region of operations. This is not really surprising, given the distance countries have had to cover from the outset, and the constantly changing nature of the financial and commercial sectors, which requires on-going adaptation to newly developed techniques. More than ever, it is important for institutions like the EBRD to continue to promote legal reform efforts from Central Europe to Central Asia, and to fine-tune the understanding of strengths and weaknesses that exist in that region's frameworks. Precise and comprehensive assessment tools are of crucial importance to guide the EBRD's future policy dialogue with governments in transition countries and the Bank's legal technical assistance efforts. This makes the work of technical advisors much more

difficult because of the need to specifically tailor policy advice to the identified needs and areas of improvement. It is already quite clear that the present challenge for many countries already well advanced on the path to commercial reforms (in the form of new laws properly implemented) is to strengthen their judicial apparatus to deliver market players the quality and predictability of court decisions and judicial support they would expect in developed economies. This is not a small undertaking by any standards. The judiciary consists of a finely balanced set of rules, institutions and people, heavily influenced by the culture and society in which they all operate. Reform requires skill, sensitivity and vision for the near, medium and long term.

The global financial crisis that started in 2008 has also shed a new light on the world's financial architecture and its regulatory aspects. Many transition countries have been seriously affected by the credit crunch and their banking sectors are struggling to cope. Governments are proposing or introducing new regulations aimed at fighting the crisis and preventing its recurrence. All these developments call for a fresh look at what international financial organizations like the EBRD can do in the sector of legal technical assistance.

For one thing, the crisis has certainly renewed the significance of the legal framework as a response mechanism to increased investment risk. The importance of legal and institutional frameworks in restoring market confidence, and providing transparency, certainty and fairness in an efficient manner, has been clearly brought home. For the first time in their (short) transition history, transition countries are testing the efficiency of their legal systems systematically on a real scale.

Secondly, because the crisis affects transition economies in different ways, future reforms or adjustments will require, more than ever, clear advice. Transition is increasingly a country-specific process where no one-size-fits-all solution can apply, and this means that legal assistance providers must be able to provide a very precise diagnosis, together with specific solutions – hence the necessity to continuously refine and review the surveys and assessments that are being conducted. Moreover, the crisis' genesis in Western markets means that Western-inspired legal and regulatory systems, which until now were perceived as reform models, may be regarded with more suspicion. Organizations such as the EBRD may need to undertake a review of the international standards it is promoting to ensure that the lessons which need to be learned from the crisis are taken into account, whilst emphasizing the commercial reform principles which remain largely valid and necessary for functioning markets. For instance, recent economic circumstances, including higher food prices, currency problems, mortgage enforcement, consumer indebtedness, and credit short-

age, have put social concerns in the spotlight – reminding everyone that economic development must go hand in hand with protection mechanisms for more vulnerable parties. The EBRD focuses on these needs to find the most appropriate way to encourage such measures be adopted in its countries of operations, in conjunction with other organizations which more traditionally address such concerns, e.g., the EU (through its consumer law) or the World Bank. On the other hand, it is also possible that governments may choose to address the shortcomings that contributed to the crisis by introducing new detailed regulations and the pendulum may well swing too far in that direction. Over-regulation would not be a satisfactory outcome from the current situation, especially in countries of the region that have previously suffered from an over-regulation problem. This is a message that the EBRD also needs to carry through to the region.

Clearly, promoting legal reform is and will remain a challenge for the time being.

Social Market Economy Values in Legal Reform Projects in South East Europe (SEE)

THOMAS MEYER

I. Introduction

The collapse of the socialist system and subsequent expansion of global economic relationships have presented the States of the former Soviet Union, East- and South East European[1] with the challenge of transforming their plan oriented economic, political and legal systems to a market oriented system. Part of this transition is a comprehensive reform of the legal system and the implementation of this by institutions and organizations.

Far from being homogenous, each country and region has specific differences. The situation in former COMECON states, independent development in South Eastern Europe (the former Yugoslavia on one hand and Albania on the other) and development in Asia cannot be compared exactly. What they have in common is, that the functions fulfilled by the main institutions in market-oriented economies also differ greatly from those in

[1] The states of East and South-East Asia, e.g. China and Vietnam are not covered by this contribution because of the author's lack of experience in these countries.

plan-oriented economies. In market oriented economies, private business activities are based on two pillars of freedom: contract and property rights. Freedom of contract ensures that entities doing business have something to act on, while property rights, protects the individual benefits. Both allow the pursuit of individual interests. In plan-oriented economies, contracts were used as a way of delegating the completion of a given plan, whilst state property effectively meant that decisions regarding production assets were made by the political regime[2].

From the very beginning, transition economies were supported during consecutive reforms by development agencies. Unilateral organizations such as USAID, GTZ, CILC[3], IRZ[4], SDC[5], ADA[6], SIDA[7], CIDA[8], DFID[9] were, and are, involved with multilateral organizations, in particular the World Bank[10], EBRD, OECD and the EU.

In most transition countries, comprehensive programs were established to support private business activities through the reform of institutions and by implementing organizations. The aim was to strengthen welfare gains in order to prevent impoverishment. A consensus existed between these organizations to ensure the introduction of freedom of contract and also to guarantee that property rights were fundamental elements of these reforms.

The impact of these programs should not be underestimated. In most important legislative projects, either one or many organizations were involved, as individual states did not have sufficient resources to implement the plans alone. The lack of expertise for the implementation of these programs, partly a legacy of decades of socialist rule, and partly due to budget limitations reducing the availability of external intellectual resources.. This was further exacerbated by the setting of completion timeframes as a condition for financial support.

Alongside the need for comprehensive and effective coordination when several organizations are involved, the delivery of policy advice is heavily influenced by different approaches from the various organizations that are

---

[2] It should not be forgotten that even in plan-oriented economies, facilities exist to delegate business decisions to (state) enterprises through rights of usage and rights of management in order to enable business to be conducted.

[3] (Dutch) Center for International Legal Cooperation.

[4] Deutsche Internationale Stiftung für Internationale Rechtliche Zusammenarbeit (German Foundation for International Legal Cooperation).

[5] Swiss Development Cooperation.

[6] Austrian Development Agency.

[7] Swedish International Development Agency.

[8] Canadian International Development Agency.

[9] British Department for International Development.

[10] Partly by group members IFC (International Finance Cooperation) and IDA (International Development Association).

involved. These differences result from different legal systems in the organizations' countries of origin and also because of the various origins of the contracted advisors. In particular, differences between the Anglo-American and Continental-European approaches are important, whilst differences between the approaches of Continental Europeans are not so obvious because of a focus on approximation to the acquis communautaire of the EU.

In this paper, the approach to legal reform projects by the development cooperation conducted by the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH will be presented and reviewed in line with the guiding principle of a social market economy. It will be shown that these projects followed the objectives of international development co-operation as set out, for example, in the Millennium Development Goals. However, a specific approach has been developed which has a substantial impact on market economy reforms in transition economies. This can be seen in the projects conducted in South Eastern Europe.

II. The overall concept of a social and ecological market economy

The key purpose for introducing the concept of a social market economy into development cooperation is the role this plays in preparing transition economies for the challenges of globalization[11]. With regard to the legal system[12], the concept was restricted to the fields of company, social and labor law[13].

Whilst social law is not covered by GTZ legal reform projects, labor law was the only one of these topics selected in certain states of Central Asia and Southern Caucasus. With respect to company law reform, it has to be considered that Continental-European and Anglo-American company law is currently undergoing a process of mutual approximation.

---

[11] See Twesten, Institutions and the Role of the State in Transition Economies in the Context of Globalisation, Eschborn, April 2006.

[12] Legal systems or law, is seen with by this contribution not for its dimensions as a sociological phenomena, but rather as a law, set by states.

[13] See Ricardo Gomez, Soziale Marktwirtschaft im internationalen Systemwettbewerb (Social market economy in the international competition of systems, p. 4 (on Company Law), p. 7 (on labor and social law), Hans Jürgen Rösner, "Soziale Marktwirtschaft und internationale Trends in der sozialen Sicherung" (Social market economy and international trends in social security), in GTZ (publ.), "Die soziale Marktwirtschaft als Leitbild für die Entwicklungszusammenarbeit" (Social market economy as a principle of development cooperation), Eschborn 2005.

The concept of social market economy has been profiled in several publications, circulated mainly within GTZ, which seek to provide an outline and confirmed interpretation[14]. These publications state that the starting point for German development assistance and collaboration, with regard to the fight against poverty or at least the prevention of impoverishment, is only sustainable within the economic system, if, social and ecological factors are observed alongside growth orientation[15]. The concept of a social market economy is not opposed to the pro-poor growth approach of the World Bank, but is based on different assumptions and reflects a specific German approach and the concretization of it[16].

In August 2007, the Federal German Ministry for Economic Cooperation and Development (BMZ) presented the "Principles of a social and ecological market economy in German development cooperation"[17]. The main principle stated that German development cooperation is led by 8 sub-principles, namely to:

1. Support the introduction of a rule of law
2. Seek distributed growth
3. Strengthen the private sector
4. Improve the business environment
5. Prepare the economy for the future
6. Establish social partnerships
7. Ecologically orientate the economy
8. Assure equal opportunities

Projects based on supporting legislative framework reform for private business activities can be attributed to sub-principles 1, 4, 6 and 8 (rule of law; market framework, social partnership, equal opportunities), particularly for the rule of law, as the projects support the creation of legal frameworks. As stated in the principles, the creation of a legal norm and its implementation to support the behaviour of the state, based on the rule of law, are the main focus of German development cooperation. The ability to enforce rights within the framework of capable judiciary, equal treatment

---

[14] See GTZ (publ.) (previous note); GTZ/Goethe Institut (ed.), "Kulturelle Voraussetzungen für die Entwicklung von Demokratie und sozialer Marktwirtschaft" (Cultural preconditions for the development of democracy and a social market economy), Frankfurt on the Main, 2005.

[15] See GTZ (publ.) (*supra* note 13), Preface by the managing director of GTZ, Eisenblätter, p. i.

[16] See Tilman Altenburg and Detlef Radke, Wirtschaftsreform und Aufbau der Marktwirtschaft: Betrachtung des EZ-Schwerpunktes aus der Sicht der TZ (Economic reform and building up a market economy: Considering the focus of development cooperation form the perspective of technical assistance), p. 146, in GTZ (Publ.) (*supra* note 13).

[17] <www.bmz.de/de/service/infothek/fach/konzepte/konzept157.pdf>.

of economic participants is strengthened and through this, so are equal opportunities and participation which are integral elements of a social and ecological market economy.

Improved market conditions for business alongside this judicial framework is an obvious requirement, calling for a consideration of the importance of the law of competition and the area of consumer protection, although neither have been included as characteristic of a social and ecological market economy so far.

Less obvious is the reference to social partnerships, stated in company law, as this sub-principle also covers mid- and long-term corporate decisions.

The alignment of economic policy advice, regarding the reform of legal frameworks based on the principles of a social and ecological market economy, will then be shown through examination of the results of practical experience in South Eastern Europe.

III. The focus of activity fields in legal reform projects in SEE

Legal reform projects linked to German development cooperation can be categorized into two types of model. Firstly, the projects that can be named and which aim to approximate what is set out in the acquis communautaire. These projects include "Support for the Approximation of Selected Areas of Economic and Administrative Law" in Macedonia, which was integrated into the project "Advice on Economic Legal Reform" and the project "Advice on EU Approximation" in Albania. which only contains a component dealing with legal reform. The other model involves a number of projects being undertaken to assist in the EU approximation process. These generally follow a more general concept regarding the overall reform of the legal framework for private business activities. These projects have been carried out in Albania since the beginning of the nineteen-nineties, in Bosnia and Herzegovina since 1996 and in Serbia since 2001 (up until 2007, and also covering Montenegro). Projects using this model include: "Amendments of Selected Economic Laws" in Albania, which is tied to a project started in 1992; the project "Advice on Economic Legal Reform in BiH", which was completed in 2007: and the project "Advice Regarding Legal Reform in Serbia". An "Open Regional Fund for South Eastern Europe – Legal Reform" was established in 2007. This fund represents a new tool for development cooperation, with its regional basis (as opposed to a bilateral basis) which supports regional (re-)integration in the field of legal reform.

Legal reform projects have mostly been designed on the basis of demand, and have thus generally employed an open concept with regard to topics raised, particularly regarding the potential scope, leaving the overall goals of these projects have been quite open. More detailed aims can be found with projects following on from completed projects or projects that have been redesigned with more detail following the reorganization of the project application system, including, for example, directions for implementation rather than for legal reform.

To document this clearly, the overall goals of projects are included within project design and are an approximation consistent with EU guidelines as follows:

- Improvement of the preconditions for EU approximation in Albania and for successful negotiations on the completion of its association.
- Approximation of the (Macedonian) economic legal system to the directives and regulations of the EU, and for its implementation of business practice, supported by competent public administrative authorities.

In contrast, the overall goals in "general" legal reform projects are:

- (Bosnian) Economic legislation and judicial institutions match the demands of an EU market which conforms with appropriate legal and regulatory policy.
- In its key areas, the legal system of Serbia matches with the demands of the rule of law as outlined in a free democratic social order, does not oppose international law and is under successive approximation to EU Law.

The variety of overarching goals does not seem to indicate an explicit directive regarding the principles of a social and ecological market economy. However, approximation to EU law and an orientation towards a free democratic legal order are seen as being of particular importance.

In the process of the project implementation, certain areas of focus arise consistently, partially due to coordination by the Open Regional Fund, and because of demand from the countries themselves[18]. This can be seen in various concrete legislative projects, which were undertaken with the support of legal reform projects and where implementation is now the key focus[19].

---

[18] The projects qualifying for the legal reform scheme are introduced by South East European governments and local partners, not by the Open Regional Fund.

[19] Information on bilateral projects and the Open Regional Fund for South Eastern Europe – Legal Reform in English, Serbo-Croatian and Macedonian languages are summarized in a brochure, which can be requested by contacting the author. See also: <www.gtz.de/de/weltweit/europa-kaukasus-zentralasien/25468.htm>.

Legal reform projects were involved in following legislative projects:

Albania – The Civil Code – Bankruptcy Law – Company Law and Company Registration Law – Law on Author's rights – Competition Law – Transactions in Securities Law – Electronic Signatures Law

Bosnia and Herzegovina – Public Procurement Law – Bankruptcy Law – Law on the Registration of Rights on Immovables – Law on Notaries – Law of Obligations – Property Law – Company Law[20]

Macedonia – Competition Law – State Aid Law – Industrial Property Law – Law on Companies in the Public Sector – Law on Mineral Deposits – Law on Handicrafts – Law on Financial Leasing – Law on Insurance Supervision – Law on the Prevention of Money Laundering

Montenegro – Law on Notaries – Law of Obligations – Property Law – Law on Concessions[21]

Serbia – Law on Transactions in Securities – Company Registration Law – Law on registered pledges on movables – Law on Privatization – Law on Financial Leasing – Law on Investment Fund – Law on Concessions[22] – The Code of Civil Procedure – Law on Enforcement – Law on Bankruptcy – Law on Companies – Law on the Cadastre, Surveying and Registering Proprietary Rights.

By comparing legislative proceedings where legal reform projects were involved, similarities can be observed in the following:

- Civil Law and related institutional and procedural issues
  - Company Law including registration of companies
  - Bankruptcy Law
  - In general, Civil Law, in particular in the field of obligations, where special attention is given to the integration of a consumer protection law and the integration of new commercial contracts into the existing legal systems
  - Substantive Property Law, which includes intellectual property and secured transactions
  - The registration of property rights
  - Law on Enforcement
  - Law on Notaries
- Public Administration Law
  - In the field of financial markets
  - Law on Competition
  - Law on Concessions and Public Procurement

[20] The law is applicable to all types of corporate organization, including partnerships.

[21] I.e. public franchises.

[22] I.e. public franchises.

IV. Description of the orientation of German legal reform projects based on the principles of a social and ecological market economy[23]

Only areas of civil law will be covered in this paper. No comments will be made regarding the extent to which the principles are relevant within the law of public administration. However, for example, the law on concessions (i.e. public franchises) is more directed at good governance, which is of great importance for all legal reform projects. Whilst the law on competition tries to compensate for failures in the market by concentrating on the power of the market, dealings in securities fall under company law. An attempt is being made to extend consumer protection to capital markets. Although this target group cannot be defined as socially disadvantaged, the value of their capital, and their investments for retirement in pension funds makes these protections worth considering, particularly in light of anticipated shortfalls in state based pensions schemes.

1. Company Law

Even before the publication of the principles, company law was identified as an area of particular importance for social market economy principles[24]. In addition to the organizational framework, employee participation in the supervisory board (or the board of directors in a monist system) was seen as being characteristic of a social market economy, and therefore an important focus for project planning. Latter topics were integrated to a lesser extent, due to a perceived lower relevance to practice. Differences in approach became evident, particularly with regard to closed corporations, specifically, with limited liability companies. Here the main source of dispute between projects concerned the retention of the minimum capital requirement for company registration. This dispute reflected the discussions taking place between EU member states. The German response to this issue involved the introduction of the "Unternehmergesellschaft" (Entrepreneurial Company) which has no capital requirements for registra-

[23] The term 'principles' refers to a policy statement of the German Federal Ministry on Economic Cooperation and Development, emphasizing that German development cooperation policies will be informed by the principles of a social and ecological market economy. Cf. the website of the Federal Ministry: <www.bmz.de/en/issues/wirtschaft/index.html>.

[24] See II. *supra*.

tion, allowing rather for this capital to be accumulated during operation.[25] Although this approach was more in line with recommendations made by other organizations[26] it cannot be said to have been overly persuasive:[27] the model that was eventually introduced retained a minimal capital requirement, although dramatically reduced in relation to other partner countries.[28] This retention of minimum capital requirements in the regulations also observes the interests of debtors and minority shareholders.[29].

Another point of major discussion was the matter of organizational structure, which rose to particular prominence with regard to joint stock companies. Here, the high level of regulation at the EU level effectively ruled out any discussion regarding minimum capital requirements. In this discussion, Anglo-American advisors recommended transition economies should move away from the continental European two-tier organization structure (which differentiates between a supervisory board and a management board), and adopt the Anglo-American system with a unitary board instead. Where both structures remain possible, this does not seem to be overly problematic particularly, if the two-tier system is retained for existing joint stock companies[30]. As the ability of two-tier systems to support mid-term oriented corporate strategies has been acknowledged,[31] it can be assumed the two-tier system will remain in South Eastern Europe for joint stock companies that are traded on the stock exchange.[32], This approach however, has more to do with South-east Europe's legal traditions and

---

[25] Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) of 23.10.2008, BGBl. I, S. 2026 (Law on Modernization of Limited Liability Companies and the Prevention of Misuse).

[26] See OECD Paper, "General Principles of Company Law for Transition Economies", 1999, p. 21 et seq.

[27] See comparable findings for Caucasus and Central Asia, Rolf Knieper, Juristische Zusammenarbeit: Universalität und Kontext (Legal Cooperation – Universality and Context, Bremen/Ferriere 2003, Point B.I.3., <www.cis-legal-reform.org/publication/articles-reports/juristische-zusammenarbeit-universalitaet-und-kontext.de.html>.

[28] In Bosnia and Herzegovina it was reduced to 2,000 BAT, which is the equivalent of 1,000 €, see Art. 314 par. 1 of the Law on Companies of the Federation Bosnia and Herzegovina and in Serbia to 500 € (Art. 112 par. 1 of the Serbian Company Law of 2004 (Official Gazette of Serbia, N. 125/2004).

[29] Which is also of particular importance in the Anglo-American approach.

[30] See Art. 329 par. 1 of the Serbian Law on Companies, where joint stock companies can choose between either form, but public traded companies need a second board which can be also be an external controller.

[31] See Gomez, "Soziale und liberale Marktwirtschaft im internationalen Systemwettbewerb" (Social and Liberal Market Economy and the Competition of International Systems), in: GTZ (*supra* note 13), p. 5.

[32] The former Yugoslav approach can even use a third body. Alongside the supervisory board and the management board the Administrative Council exists.

their relationship to the continental European system than the advantages of midterm oriented corporate strategies.[33]

Approaches to company registration also differed widely, with the main debate connected to the effect of registration and the evaluation of the preconditions for company registration. Additionally, heated discussion has surrounded the question of where registration should take place, remaining with the courts, or whether new agencies will have to be established. While retaining the effect of the constitutional requirement to register a company through an act of the state, many countries have established new agencies for this purpose, which often lack the authority or the ability to check suitability of applications as against the criteria for registration.

The legal reform projects undertaken as part of German development cooperation have not yet expressly been related to the principles of a social and ecological market economy, nor only focused on the impact of socially balanced reforms. Instead, they have sought to develop more general approaches within policy advisory projects, in particular in the area of legal reforms. Reform does not have to be radical change, rather an alteration or amendment to a pre-existing substantial institutional structure[34]. This reduces the costs of transition by easing the educational burden for those who must apply the new rules – educating judges, attorneys, public clerks and businesses on the changes as they apply to them, rather than learning a whole new system. Training may be based on existing knowledge, and, to draw on the example of company law, should not require changes to organizational matters purely as a result of changes in the legal framework An additional benefit, is the prevention of conflicts between institutions, particularly with regard to the shifting of authority from one body to another, or the establishment of new organizational structures where these were not been essential for transition. Newly established organizations must continue to exist after development cooperation with them has ended in order to maintain long-term stability. Last but not least, the creation sustainable and stable legal systems in transition countries mean they should not be used as laboratories for testing new regulatory concepts in European and International Company Law[35].

---

[33] See for Bosnia and Herzegovina Rajcevic/Simic, Harmonization of Laws on Companies – Companies in Bosnia and Herzegovina, the Judicial Training Centre of the Federation of Bosnia and Herzegovina, Sarajevo/Banja Luka 2005, p. 4.

[34] A summary of this approach can be found in, Knieper, Universality and Context (*supra* note 27), point A.

[35] The example given concerns cumulative voting in Art. 309, in the Serbian Law on Companies, which was introduced on the advice of an Anglo-American advisor.

2. Law on Bankruptcy

German legal reform projects in most countries have been involved in the reform of bankruptcy laws[36]. These reforms must be seen in the context of general company law reforms. As a result of the involvement of different organizations, former unitary legal systems have introduced different approaches, with some following the "German" approach, and others orienting themselves more around Anglo-American system[37]. Similar linkages apply in the development of reforms to the system of enforcement, particularly for supporting privatisation measures. Bankruptcy is declared after the failure of a privatization procedure for state owned companies[38]. Within the bankruptcy proceedings, arrangements for employees are also an important, but not decisive difference. The setting of laws however does reveal some significant differences, mainly due to differences between the national legal systems. These reforms satisfy sub principle 1 "support of the rule of law" and sub principle 4, the "improvement of business environment" of the BMZ principles: an effective bankruptcy law supports the reintegration of private assets back into a business along with the enforcement of claims made during bankruptcy proceedings.

3. Law of Obligations

Next to property law, the law of obligations is a central element in any civil law system. In contrast to other transition countries, a modern law was already in force in the former Yugoslavia. It followed the essence of the Swiss Law of Obligations and was implemented through a dedicated legal practice and academic base. Despite that, legal reform projects were[39] and have been[40] active in the field in order to integrate EU directives into

---

[36] This is true for all countries covered by the Open Regional Fund for South East Europe – Legal Reform (Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia), except for Macedonia, which is participating in a related component of the ORF (on Company, Bankruptcy and Enforcement Law).

[37] See Garasic, Voraussetzungen der Anerkennung ausländischer Konkurs- bzw. Insolvenzverfahren nach kroatischem Recht, in: Das Ohrider Symposium/Simpozijum u Ohridu, Bremen, 2004, Robert Gourley, Mahesh Uttamchandani, "From Sea to Shining Sea: How Serbia and South-Eastern Europe Have Taken the Lead on Insolvency Law", International Corporate Rescue February 2005, p. 5 (which criticized mainly the lack of harmonization in regional developments from different point of views).

[38] See Knieper, Universality and Context (*supra* note 27), point B.I.7.c).

[39] In Albania, the set up of the Civil Code has been supported since the beginning of the 90's and was enacted in 1994.

[40] In Bosnia and Herzegovina, the comprehensive completely new draft stagnated in a constitutional debate, after it was planned to enact the law on the Central State level. The draft was used for the new Law on Obligations in Kosovo, as the same international experts were in charge (Prof. Rüssmann from the University Saarbrücken). Following

the current law. These activities were often undertaken in conjunction with other related projects, under the regulations of special laws to ensure coherency with the legal system in general and the law on obligations in particular. For example, drafts for the Law of Financial Leasing in Serbia were presented which were inconsistent with the Law on Obligations. An acceptable solution was developed with the assistance of the bilateral project in Serbia.

In general, the introduction of modern types of contract, and the concommitant trend for special legislation represents an important issue in international cooperation regarding legal reform. Often reform projects have been commenced even when contracts can be managed through the application of the existing law on obligations. Despite this, special regulations seem to have received a certain level of promotion, have generated training opportunities and reflect current legislative needs, which cannot be managed through law of obligations integration, where at least a mid-term approach is needed[41].

The activities of German legal reform projects are all well aligned with the principles of a social and ecological market economy, and therefore, sub principle 4, the "improvement of the business environment". This effect is derived from interfaces with the legal framework for market activities, but also touches on sub principle 1, the "introduction of the rule of law" which is one of the cornerstones of the civil law system.

In addition to managing modern contracts, one main subject regarding the work surrounding the law of obligations, is the integration of consumer protection law in South East Europe. In most countries, special laws have been enacted to regulate aspects of consumer protection regarding public administration of civil laws. This carries an inherent risk of inconsistency, as seen in the current[42] Law on Consumer Protection in Serbia, which was enacted in 2005. In the current Law of Obligations, articles 142 and 143 deal with general contract terms. To be in line with current consumer protection directives, clause examples of invalid or unfavourable terms, along with regulations regarding main contract duties and the introduction of collective action suits, had to be introduced[43]. A conflict within the new

---

that, activities in Montenegro were supported and a Serbian expert (Prof. Perovic from Belgrade) was involved.

[41] See Thomas Meyer, Potreba zakonskog regulisanja novih vrsta ugovora u zemljama sa tradicijom gradjanskog zakona [The needs for statutory regulation of modern contracts in civil law countries], Pravo I Privreda 2005 No. 5–8, p. 303.

[42] There is currently a working group preparing a new draft law on consumer protection which is supposed to be introduced during 2009.

[43] The latter is regulated in procedural laws.

regulations, regarding the law on consumer protection, shows[44] that the provisions in the law of obligations are slightly more biased towards consumers and are therefore, to some extent, more suitable for approximation to related EU directives. In court practice, judges now have to deal with the task of defining relationship between the new Law on Consumer Protection and the regulations from the old Law of Obligations. To the present date it is unclear whether or not the old rules were made obsolete, superseded by the newer Law on Consumer Protection. Clarification is also needed as to whether the new law only applies in the regulations which are not included in the Law of Obligations. These questions make the implementation of the Law on Consumer Protection more complicated, a situation which could have been prevented through broad discussions in the Yugoslavian legal community, drawing on the existing familiarity with the Law of Obligations..

As consumer protection is specifically named in the principles for a social and ecological market economy operating with development cooperation[45], relevant activities do follow these newly formulated principles. Through modern consumer protection, asymmetries concerning regulations regarding information in the market can be identified and compensated for, alleviating the perceived inferiority of consumers, compared to those who are selling the products. This is a response seeking going beyond a mere approximation with the acquis. German consumer protection locates consumers within the principles of a social state based on the protection of disadvantaged persons, whilst the term 'consumer' relates purely to the market in the European context.[46].

The support of legal reforms in the field of consumer protection within German development cooperation follows these principles. Reforms, even when focused on achieving approximation to the acquis communautaire, generally achieve a broader outcome.

4. Property Law

Property law reforms are key aspects of German development cooperation in the field of legal reform in South Eastern Europe, although these activities are less related to restitution, which is often a politically sensitive issue. German expertise was sought, drawing on the experiences of reunification (although this is not directly comparable to the situation of tran-

---

[44] Independent because of the fact that the law from 2005 is partly not in line with EU standards.

[45] See sub principle 4 at the end.

[46] See Micklitz, Münchener Kommentar zum Bürgerlichen Gesetzbuch (Munich Commentary on the German Civil Code) (in the following: MüKo/Author), Preliminary notes to §§ 13, 14 BGB, side no. 95, 5. issue, 2006.

sition economies) despite the political risks inherent in basing reforms on external advice. In this field, social elements are seen as important whilst general considerations have to be fair and relevant[47].

For countries with developing and transitional economies, the importance of property rights been always understood on a totally different basis for property rights in contrast with the function of the same in market oriented systems[48], particularly for former socialist countries,[49]. Despite a decreasing importance regarding property rights in material terms and in terms of the means of production in developed legal systems,[50] support for the reform of a substantial property law for material items, represents an essential part of the advisory services in South Eastern Europe. This is, especially true for property rights for immovable objects, where the introduction of indisputable rights is important to open access to credit by providing security rights on immovable objects., The administrative structures for implementing authorities (land registries etc.) are a core element, which are only partly covered by special projects form an important part of the reform of actual substantial property law[51]. Since intellectual property rights are limited by the scope of the WTO special projects on accession handle these issues. The legislative situation is comparatively well developed, as special laws on trademarks, patents, utility patents and author's rights existed during the former Yugoslavia. Substantive property law, however is quite different: Under the former federal structure this was controlled by the respective republic, while at the federal level, only a basic framework of laws existed. The wars in the Balkans and the subsequent need for urgent action led to a ragged approach across the partner countries. German projects focused on property rights regarding material things and rights on immovable.

---

[47] See Option Paper of the Center of Legal Competence, "Privatization of Construction Land in Urban Zones Including Restitution", (not published), p. 50, 2006, which was supported in cooperation of German GTZ, Austrian ADA and Swiss DEZA.

[48] See Hernando de Soto, "The Mystery of Capital", 2000.

[49] See remarks in the introduction. See Rolf Knieper, Rechtsform und Gesellschaftsform, Festschrift für Rolf A. Schütze (Legal Form and Social System, Festschrift for Rolf A. Schütze), Munich 1999, p. 389 ff.

[50] See Knieper, "Von Sachen und Gütern – in neuen und alten Kodifikationen", (Of Things and Goods – in new and old codifications) in: Rolf Knieper, "Rechtsreformen entlang der Seidenstraße" (Legal Reforms Along the Silk Road), Berlin 2006, p. 189–202, p. 190.

[51] The example given refers to a land management project in Bosnia and Herzegovina, carried out with co-financing from Sweden and Austria, which was established as a result of preparatory work done within the project "Economic Law Reform". The subsequent GTZ project in Serbia on land management is partly based on preparation work carried out by the project "Advice for Legal Reform in the Federal Republic of Yugoslavia".

As in other fields, German projects benefit from the similarity of the legal structures in South Eastern Europe to the German tradition, due to their Austro-Hungarian influence. This is particularly true regarding property law, where similarities are even more visible than with the law of obligations, which also have a French influence.

Differences between projects run by other organizations, particularly USAID, have arisen due to their different legal traditions. Within the Anglo-American legal systems, no detailed differentiation between absolute and contractual rights exists[52]. In practice, American projects, which rarely focus on property law, deal predominantly with registered pledges on movables. Within these projects, partial drafts have been presented, which are neither consistent with civil law approaches nor fit with legal traditions present in South Eastern Europe[53]. In other regional countries, local legal traditions were better respected in projects supported by the EBRD.[54]

Even if the introduction of legal security, as contained in sub principle 1 of the BMZ principles, is of major relevance, German property law shows that social elements, e.g. the principle that the sale of goods does not terminate a rental contract[55], are a special feature of German law[56]. Despite these social aspects,[57] it must be stated that the support of property is mostly focused on legal security, specific regulations to protect socially disadvantaged persons are only considered in connection with other issues, particularly regarding the enforcement of the law.

5. The Registration of Proprietary Rights

Property law reforms are accompanied by a reform of the register for rights on immovable and registered pledges on movable objects. The register of

---

[52] See my contribution for the annual meeting of the Kopaonik School for Natural Law in 2006: Strukturne razlike između anglosaksonskog i evropskog kontinentalnog prava vlaštništva [Structural differences between Anglo-American and Continental-European property law], Pravni Život 2006 No 10, p. 491.

[53] E.g. the Bosnian Framework Law on Pledges, which came into force in 2004.

[54] E.g. the Serbian Law for the Registration of Pledges on Movables, which was enacted in 2004. See also as an overview of the region: Meyer/Athenstaedt, "Introduction of non possessory registered pledges in South East Europe", Contribution to the conference "Problems of contract law in the states of Caucasus and Central Asia", 10 and 11 April 2008, under publication.

[55] See § 566 BGB.

[56] See MüKo-Häublein, § 566 BGB, N. 6, (4th ed., 2004) see in conflict with § 1120 of the Austrian Civil Code, where it is regulated, that only registered rental agreements continue to exist after sale, which is not possible under German law.

[57] And other aspects, arising from acquiring a monopoly of legal positions through legal regulations, see Knieper, Of things and goods (*supra* note 50), p. 191.

rights on immovable objects exists in Continental and European legal traditions, as a source of information which benefits from constitutive effects of registration. Changes to rights disregarding this register do will produce legal effects only under very limited circumstances. Whilst this permanency applies to the register for immovable object rights, other organizations have demonstrated a focus on information and in particular information regarding credit related to business. German projects, tend to focus mainly on the implementation of general principles for registration[58]. This includes a legal check up of the state authorities involved in the registration process, to prevent state influencing of registration, and guarantee the independence of registrars, thus preventing undue influence from the executive branch. The systems in place vary across the region, for those regions which were under Austro-Hungarian influence land registration is carried out by courts, which have come to play the role of a third pillar in the division of power required for the aforementioned independence. However, a similar court administered land register also exists in Slovenia, Croatia, Bosnia and Herzegovina and parts of Serbia (in particular Vojvodina but also urban areas), where a court system was established after World War I. No uniform rule exists in territories which were influenced by the Ottoman Empire (South- and East-Serbia, Albania, Macedonia) or in those which were not directly connected to the Austro-Hungarian sphere (Montenegro). Other systems involve a collection of documents, which can be compared with the Turkish system, whilst in other parts, registration was carried out with the cadastre (land registry) or no register exists at all.

GTZ's approach has always been neutral regarding institutional setting. As there is a need for independence regarding the registration process, court based systems are often reasonable, particularly as they can be easily set up within general court independence procedures ruling out state liability for incorrect registration to some extent. However, experience has shown that working systems can be set up outside the court system. Other organizations, in particular the World Bank, insist on integrated solutions referring to the poor state of the court systems in general, which may cause delays in the establishment of registers[59].

Social aspects are slightly outweighed by considerations regarding the strengthening of the rule of law, as stated in subprinciple 1 of the BMZ principles. These is however a social element introduced by the fee struc-

---

[58] See the opinion paper prepared by Prof. von Schuckmann on the Serbian draft Law on Cadastre, Surveying and Registering Rights on Immovable Objects, see also the commentary by Weike/Tajic on the Law on the Land Registry in BiH.

[59] Surveys show that with a court system, timely registration is also possible whilst the main delays are generally caused by the initial registration of a plot, also where integrated systems are in operation.

ture for entries. Where these are calculated according to the value of the real estate, the question of cross-subsidy of fees for high value entries arises, fees are higher with higher value based entries, although the necessary resources for registration are comparable. As a result, transaction costs for real estate transfers (or the establishment of security rights for example) are less than those for high value transactions. Thus it could be said that there is a social component in the real estate market, which is connected to the orientation of the principles of a social and ecological market economy, and beyond the scope of sub principle 1 (the introduction of the rule of law)[60].

It should not be overlooked, that elements of a social market economy did well exist before the term "social market economy" was introduced into political debate during the second half of the 20th century[61]. Similarly, land registries had already been introduced early in the 19th century. What we commonly classify as a social market economy is not a invention of recent politics. Instead, it was built up and developed (along with other systems) in a way which is documented in sub-principle 1of the BMZ principles. The same holds true for Company Law, where a two-tier system in joint stock companies was introduced in the 19th century.

6. Notaries

The process of introducing latin notaries into the countries of South East Europe ranges from commenced[62], to completed processes[63]. In Bosnia and Herzegovina, Montenegro and Serbia this process happened with the support of GTZ legal reform projects in close cooperation with activities carried out by the German Foundation for International Legal Cooperation[64] and other organizations, for example, the Konrad Adenauer Foundation[65]. Latin notaries represent an important part of a reformed institutional setting together with the judiciary. In reflecting Austro-Hungarian and German traditions, notaries assume duties in the field of voluntary (non-contentious) jurisdiction, while the judiciary performs its function on the

---

[60] See comparable argument regarding the fees of notaries.

[61] Alfred Müller-Armack, Wirtschaftslenkung und Marktwirtschaft (Steering of the economy and of the market economy), 1946.

[62] In the Federation of Bosnia und Herzegovina, Latin notaries started to work on 5 May 2007, whilst in the Republic of Srpska, they started to be present early in 2008. In Montenegro, the introduction of Latin notaries will take place soon, whilst in Serbia the law is still under the process of being completed.

[63] Slovenia, Croatia, Macedonia, Hungary, Romania, Bulgaria, Czech Republic and Slovakia introduced Latin notaries, in part,15 years ago and have had positive experiences with this.

[64] In particular in Albania, Bosnia and Herzegovina and Serbia.

[65] Project involved carrying out political preparations in Montenegro.

basis of a 'two pillar' model of non-contentious justice[66]. Registers are another example of this kind of institutional setting for the prevention of disputes, holding specific powers for registering rights, and guaranteeing the correctness of those rights and facts, regardless of whether they have been established within courts or by independent authorities. In all cases, these registers strengthen legal security regarding important economic resources or facts[67]. The second pillar, which was named in the former Yugoslavia as a 'non-dispute judiciary', works well with local legal traditions including those which were followed during the socialist era.

Latin notaries differ from the notary public in common law legal systems as they can fulfil state functions in civil law countries, rather than merely officially witnessing signatures. This subject is currently under discussion within the European Union, but is acknowledged in several legal acts determined by the EU[68]. One of the main functions of Latin notaries is to create evidence in legal relations, to give impartial legal advice and on some occasions, provide an insurance function.

This creation of legal evidence is one of the key functions of the Latin notary. The involvement of an impartial third party, appointed by the state, who creates a legal document from the original documentation and hands over official copies only, ensures that original texts cannot be falsified. Notarised documents (deeds) are awarded a special trust in legal transactions because of these procedures.[69]. The evidence they provide is given extra weight in national court proceedings and they were granted the status of an executive title in the European Union[70].

One of the most important duties of Latin notaries[71] is the provision of impartial advice, comprising comprehensive information on the entire content legal content of a notarized document. Along with legal security regarding the expectations of involved parties, this service serves as a primary source of providing information to a less informed party. This func-

---

[66] See <www.bnotk.de/Service/BNotK-Intern/2007/BNotK-Intern_2007_1_01.html>.

[67] E.g. on the legal representatives of corporate bodies.

[68] See Regulation (EC) No 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims (OJ L 143, 30.4.2004) and Directive 2005/36/EC of the European Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications (OJ L 255, 30.9. 2005), where Latin notaries are excluded because of their state function.

[69] See no. 1.1. par. 1 of the "European Codex of Notarial Practice" prepared by the Conférence des Notariats de l'Union Européenne in the version by 9 November 2002, available in French, Italian and German only, see <www.cnue-nouvelles.be/en/002/003. html>.

[70] See Regulation on the European Enforcement Order (*supra* note 68).

[71] See Art. 80 and 81 Law on Notaries of the Federation of Bosnia and Herzegovina. See no. 1.1. par. 3 and no 1.2. par. 2 of the European Codex (*supra* note 69).

tion allows, notaries to compensate for irregularities in information provided, creating equality between parties recognised by civil law[72]. On the basis of the information received, the third party may withdraw from a legal transaction, based on the advice given regarding legal consequences,. Should the party choose withdraw, it cannot invoke a claim of nescience without engaging an attorney for additional legal advice.[73]. This process contributes much towards the prevention of disputes and improving legal security, in turn reducing both the costs of general legal advice, and for the costs of legal representation in trials. The reintroduction of notaries into South East Europe where no duty to notarise real estate transactions exists, it can be seen that Latin notaries clearly serve a public need, as most real estate transfers are notarized on a voluntary basis[74].

A valuable element of the services carried out by notaries in relation to notarizing legal transactions, is their professional indemnity insurance. This obligation to hold appropriate liability insurance to cover potential damages and also carries special appointment procedures and further training obligations. This means that parties engaging a notary do not need to check qualifications, but can be certain that they will not suffer loss or damages, as this is covered by professional liability insurance even if the notary cannot personally pay compensation due to lack of funds[75].

A social element to this process is introduced again through the fee structure[76]. Thus, the involvement of notaries increases legal security, but also increases transaction costs. These costs however are partly shifted to less valuable legal transactions. The social element is further enforced by the use of registries, which provide greater information and access to legal advice for lower socio-economic groups in the community, who may previously have not sought to protect their legal rights in this manner in order to reduce costs[77].

The support from German development co-operations for the introduction of Latin notaries as part of overarching legal reforms, was guided by the principles which govern a social and ecological market economy.

---

[72] See Markus Sikura, "Der Notar im sozialen Rechtsstaat" (The Notary in the Social Constitutional State), Hamburg, 2007, p. 341, where the role of notaries within consumer protection is reflected.

[73] Attorneys were in opposition to the introduction of notaries, See Dnevni Avaz by 25 July 2007.

[74] The number of rejected applications made to the land registry in Croatia decreased dramatically as a direct result, of the involvement of notaries in real estate transactions.

[75] See Sikura (*supra* note 72), p. 395, Thomas Meyer, "Professional liability insurance for (legal-)advisory professions in Germany" Paper prepared for the annual meeting of insurance lawyers association of Serbia in September 2004 in Budva, Montenegro.

[76] See Sikura (*supra* note 72), p. 383, 396.

[77] See Sikura (*supra* note 72), p. 397.

These services have had the additional benefit of strengthening legal security (sub Principle 1), correcting information asymmetries and redistributing related costs according to social criteria[78].

7. Enforcement Law

The enforcement of civil claims did not feature in plan-oriented economies, as the private sector did not play a significant role in the economy. For market oriented-systems however, the importance of enforcement and its apparent central role in the system cannot be overstated. Reforms to substantive law, and the adjustments made for a market-oriented system does not provide any benefit if the state does not provide a court system to try civil claims. If enforcement must be carried out through the legitimate use of physical force, under the German approach state authorities should exercise this use of force[79]. Enforcement laws must be strictly regulated to ensure that social elements are not overlooked in the exercise of state power. These social elements include ensuring that debtors retain a sufficient level of assets required to maintain a level of existence with dignity during the enforcement process without impinging on debtors' dignity[80]. As these principles are often overlooked or under-emphasised by other international organizations, these principles should be included as a matter of course into legal reform projects particularly in the areas of enforcement, even when not explicitly called for in sub principle 1 of the BMZ principles of a social and ecological market economy[81].

V. Summary

German Technical Development Cooperation legal reform advisory projects are geared towards strengthening the principles seen in social and ecological market economies, by developing legal frameworks for private business activities and for transforming planned economic systems into market-oriented ones,. The main focus is on projects which aim to introduce and strengthen the rule of law as part of good governance practices,

---

[78] See Sikura (*supra* note 72), N 72, p. 237.

[79] See Knieper, "Privatization of Enforcement is not the Answer", in: Legal Reforms Along the Silk Road (*supra* note 50), p. 291, 292.

[80] Potentially different approaches of other organizations are by a contribution of a representative of IFC (International Finance Cooperation) on the Conference "Collateral Reform and Access to Finance" (at EBRD in London 2006) where he reported on good experiences with the destruction of pledged vehicles or/and the publication of photographs in daily press.

[81] See *supra*, III.

as detailed in sub principle 1, and the improvement of business environments (sub principle 4). Although services provided in this advisory capacity do not have a value in themselves for the creation of social welfare, they do serve as a valuable tool in this regard. Additionally, appropriate regulation of market systems provides a mechanism for the state to monitor and compensate for the failures of the market, particularly with regard to socio-economically disadvantaged groups. The social market economy model developed this way, based on legal traditions which are related to the legal systems of the states of South Eastern Europe. The principles of a social and ecological market economy, as published by the German Federal Ministry on Economic and Development Cooperation have also significantly contributed to this development. Legal fields, which characterize a social market economy, namely labour laws, social and corporate laws, must be developed. Along with the explicitly cited consumer protection law, this is particularly true for a non-dispute related judiciary (notaries and property rights including related institutions)[82] but is also true for the area of enforcement, where social aspects take on special importance. In contrast with the approaches of other organizations active in development cooperation in the field of legal reforms, the orientation towards the principles of a social and ecological market economy represent a unique feature of German Development Cooperation in this field.

[82] See Sikura (*supra* note 72), p. 119.

B. Civil Law – General Aspects

Development of Private Law on Contracts in the Russian Federation

ALEXANDER KOMAROV

I. Historical Introduction

An objective assessment of the situation relating to the present state of Russian civil law should inevitably include historic analysis of its development over the course of the last two centuries. The existing legislation of Russian Federation on property relations reflects the result of efforts to create the system of rules which could be adequate to the needs of the society at a particular moment of national development.

In the beginning of the 20th century Russia had made quite substantial progress in industrial development and showed a great potential for further economic evolution. Such speedy development demanded effective regulation to secure expanding market relationships and facilitate the building-up of a national economy. Russian civil law at that time was represented by rather loose codification developed during the 19th century.[1] The Russian Imperial government had already set up a commission to work out a comprehensive draft of new legislation covering almost all fields of civil law at the end of that century in order to create modern and better codified legal rules for civil relationships. This commission included high-level state officials and legal practitioners and academics. After a long period of

[1] See Svod zakonov grazhdanskikh Rossiiskoi imperii, kodifikatsiia rossiiskogo grazhdanskogo prava, izdatel'stvo Instituta chastnogo prava, Ekaterinburg, 2003, p. 37.

extensive work which included public discussion of preliminary projects the consolidated text of draft Civil Code was published in 1910.[2] A two-volume publication included explanations and commentaries of the drafting commission.

Shortly before the First World War the draft Civil Code was presented in the Russian Parliament (*the 4th State Duma.)* Although some parts of the draft went through the first reading during the following years, the Socialist Revolution of 1917 and the Civil War in Russia (1918−1920) prevented the continuation of work to codify Russian civil law. Unfortunately, this thoroughly prepared draft of the Russian Civil Code never became formal law in Russia. But in spite of that the immediate ill-fated result, the draft played quite an important role in further development of civil law in new Russia which occurred in the next decade.

In order to assist the national economy to recover from four years of Revolution and Civil War, it was necessary to introduce civil law regulation which did not exist at the time in Soviet Russia. Additionally, social order and the economic situation in the country were extremely unstable. In an attempt to prevent further decline of the national economy, the Soviet Russian government proclaimed the New Economic Policy in the early 1920s, permitting free market relations and business activities within the country, although to a limited extent.

As a result of a hasty but rather successful effort to provide a legislative basis for the permitted range of private economic activity the Civil Code of the Russian Soviet Federative Socialist Republic (RSFSR) appeared in 1922. An important aspect of this development was the fact that along with foreign sources, the drafters of 1922 Code drew on the draft text of the Russian Civil Code which had been prepared before the Revolution. A short while later, the Soviet Union (USSR) including about a dozen of union republics was created at the end of 1922 and these republics copied almost verbatim the RSFSR Civil Code as their local civil law.

The USSR Constitution adopted in 1936 included a provision for replacing the republic civil codes with a single Civil Code for the whole of the Soviet Union. This would have meant that the competence to pass civil legislation would be vested in the Union, not the Republics. However, eventually the Constitution of 1936 was amended to provide for adopting "Fundamentals of Civil Legislation" at the USSR level and for adoption of more detailed separate civil codes by each union republic. Actually, the USSR Fundamentals of Civil Legislation were formally adopted only in

[2] See Proekt Grazhdanskogo ulozheniia Rossiiskoi imperii, kodifikatsiia rossiiskogo grazhdanskogo prava, p. 321.

1961. New union republic civil codes then followed, including the 1964 Civil Code of the Russian Soviet Federative Socialist Republic (RSFSR).[3]

As some steps to ease the centralized economy and permit elements of a market into the Soviet Union had been announced in the late 1980s in accordance with the new social-economic policy called "perestroika" (restructuring) it became obvious that the 1964 Civil Code could not serve its proclaimed purpose since it lacked substantial elements that may be characterized as private law. It was based on the principles not consistent with the private law concept, as socialist civil law in the field of economic activity was actually a means of regulating the national economy which was dominated by the public interest. Civil law in the Soviet Union did not recognize free entrepreneurship, private property or freedom of contract, or any kind of private business organizations. Actually the whole legislation relating to economic activity based on RSFSR Civil Code of 1964 became obsolete in the new social-economic situation.

Reformation policy was also concerned with legal matters. The Fundamentals of USSR Civil Legislation were enacted in August of 1991 as the result of the efforts to adapt existing Soviet civil law to the general liberalization process of social-economic conditions. The act was to take legal effect from 1 January 1992.[4] However, the collapse of the Soviet Union in December 1991 made this impossible, leaving the outdated RSFSR Code of 1964 as the major source of civil law in the territory of the newly independent Russian state. In an attempt to avoid negative consequences of a legal vacuum for evolving private business activities, the Supreme Soviet of RSFSR (the parliament) adopted the 1991 USSR act in July 1992 as Russian Federation legislation for the area of civil law.[5]

As the "USSR Fundamentals" contained only basic rules reflecting a more liberal approach to civil law they were not sufficient to provide the necessary legal infrastructure for economic activity in new decentralized system. This led to the commissioning of extensive drafting work on a new Civil Code. In this respect it must be noted that the Research Center of Private Law at the President of Russian Federation played an important role in the realization of these plans. That academic institution was created in 1992 as one of the means of implementing the Program of Revival of

---

[3] See, for example, the text of the RSFSR Civil Code (1964), in: S. N. Bratus', O.N. Sadikov, *Kommentarii k Grazhdanskomu kodeksu RSFSR*, 3rd ed., Iuridicheskaia literatura, Moscow, 1982.

[4] Osnovy grazhdanskogo zakonodatel'stva Soiuza SSR i respublik, passed by the Supreme Soviet of the RSFSR on 31 May 1991 N2211-1.

[5] Postanovlenie Verkhovnogo Soveta Rossiiskoi Federatsii 14 July 1992, No. 3301-1 and 3 March 1993, No. 4604-1.

Private Law in Russian Federation.[6] In the years that followed the Center was actually the principle body responsible for preparing of the draft Russian Civil Code and its amendments, a position it has retained to this day.[7]

Continuity of the legal traditions used in developing new civil law rules was secured by the fact that the major part of the draft text of new Civil Code was based on preparatory codification works started in late 1980s in accordance with "USSR Fundamentals" to amend RSFSR Civil Code (1864). The amended text had to accommodate new elements of market economy into existing legal order to align socialist civil law with the policy of "perestroika". But the draft RSFSR Civil Code permitted only quite limited number of new market oriented rules to be integrated into a legal system which, in principle, was based on a socialist doctrine of civil law. It has been suggested that the fact that this draft was extensively used in codification work started in 1992 when social economic conditions had dramatically changed considerably influenced the contents of the new Russian Civil Code, making it not consistent enough with private law approach in particular regulation in some areas.

The radical shift from state planning to a market economy was confirmed by the new Constitution of the Russian Federation which was adopted in 1993 and finished the socialist period of Russian history. This reinforced an urgent need for new comprehensive civil law which had to provide a stable foundation for developing private law relations, particularly in the economic field, primarily in the fields of property relations, business organizations, contracts, and other areas of commercial law.

That was one of the reasons why the new Russian Civil Code did not appear at once as single piece of legislation. The rapidly developing social-economic situation in Russia demanded immediate reaction on the part of the State. As the production of a text that covered all areas of civil law would have taken considerable time, it was decided to enact the Civil Code in separate parts as soon as their drafting was completed.

Apart from practical considerations there were also political reasons relating to the process of creating a new Civil Code. Key among these was the need to introduce a general legislative act as soon as possible to promote the rebirth of private law within Russian national legal system. The adoption of the Civil Code as a unitary act covering all property relations (commercial and non-commercial) was also aimed at preventing the attempts of a conservative political opposition to keep the concept of "eco-

---

[6] See Rasporiazhenie Prezidenta Rossiiskoi Federatsii 14 July 1992 No. 360-RP *Ob obespechenii deiatel'nosti issledovatel'skogo tsentra chastnogo prava.*

[7] See Ukaz Prezidenta Rossiiskoi Federatsii 18 July 2008 No. 1105 *Ob issledovatel'skom tsentre chastnogo prava pri Prezidente Rossiiskoi Federatsii. Sobranie zakonodatel'stva Rossiiskoi Federatsii 21 July 2008.*

nomic law" (*chosyastvennoe pravo*) that had dominated the Soviet centralized economic system alive in the new social and economic environment. The concept of "economic law" was founded and developed on the idea of active involvement of the State in economic life and it would deny a private law approach in economic matters as a matter of principle.

The Part One of the Civil Code that covering the general principles of civil law, property law, business organizations and general principles of contracts and other kinds of obligations was adopted in 1994. Part Two followed quite soon in 1995. It dealt with specific types of contracts and non-contractual obligations such as liability for causing harm (torts), unjust enrichment and *negotiorum gestio*. Part Three of the Civil Code which dealt with the law of succession and international private law was adopted on 26 November 2001 and took effect on 1 March 2002.[8]

The fact that adoption of the remaining Civil Code took more time than it could be expected was not actually connected with legal technicalities, but was due to the fact that initially Part Three was planned to also include rules relating to intellectual property. This topic had generated a great debate in professional circles likely to be affected by new rules which envisaged substantial changes of legislation already adopted in the new economic environment by abolishing the very rigid regulation of the past. There was serious criticism of the draft rules relating to considerations of economic policy in domestic and international aspects. There was also rather strong opposition to including regulation of intellectual property in the Civil Code arguing instead for separate legislation not formally connected with the rules of Civil Code. In order not to delay introduction of the unopposed rules on succession and international private law that had been formulated in alignment with new developments it was decided to exclude rules on intellectual property from Part Three for the time being.

It took another six years to overcome differences of opinion relating to the new regulation of intellectual property. Advocates of a legal regime for intellectual property independent of the Civil Code lost in the end. In December 2006 the Fourth Part of the Civil Code titled "Rights to Results of Intellectual Activity and Means of Individualization" was passed and became federal law on 1 January 2008. It provided ample regulation on copyright, patents, trademarks and other objects of intellectual property in more than three hundred articles divided into general and special parts dealing with different objects of intellectual property law. As a matter of fact Part Four of the Russian Civil Code might be called "a code" itself.

---

[8] See English translation of first tree parts in publication "Civil Code of the Russian Federation/Parallel Russian and English Texts". Edited and Translated into English by *Peter B. Maggs* and *Alexey N. Zhiltsov*. Izdatel'stvo NORMA, Moscow, 2003.

Upon adoption of each successive part of the new Civil Code the corresponding parts of the 1964 Civil Code and the 1991 USSR Fundamentals were repealed. Adoption of each part of the new Civil Code was supplemented by transition rules that dealt with complex problems of movement from the old law to the new. With the adoption of Part Four of the Civil Code, the Russian civil legislation based on the 1964 Civil Code was completely repealed, completing the first phase of modern codification of Russian civil law begun in the early 1990s.[9]

Concerning the system of legal sources of Russian civil law it is necessary to underline that the power to enact civil legislation is vested with federal institutions in accordance with the Russian Federation Constitution. Constituent parts of the Russian Federation (Federation subjects) have no authority to pass laws relating to the regulation of civil relations. Russian Federation civil law legislation consists not only of the Civil Code of the Russian Federation but also includes a number of other federal statutes. In many instances enactment of particular statutes is provided for in the Civil Code as legislation implementing its rules.

Civil law relations in the Russian Federation may be regulated also by edicts of the President as well as by the Government of the Russian Federation. Where an edict of the President or a decree of the Government of the Russian Federation contradicts the rules of the Civil Code or other statute, the latter should prevail. Federal ministries and other federal agencies of executive branches may issue acts containing norms of civil law within the limits of their authority.

The Code lays down an important principle that should be followed in developing civil law legislation in Russia. It provides that civil law rules contained in other statutes must correspond to the rules in Civil Code. In other words it provides the superiority of the Civil Code over any civil law rule contained in other acts. One might say that such a rule may create an obstacle to the development of civil law by way of introducing new legislation beyond Civil Code. But it was a deliberate inclusion in the Civil Code in an attempt to stabilize civil law by preventing any attempts to dilute the systematic structure of the Code by introducing inconsistent laws.

---

[9] See D.A. Medvedev, *Novyi grazhdanskii kodeks Rossiiskoi Federatsii: voprosy kodifikatsii (New Civil Code of the Russian Federation: Questions of Codification)*, in: Kodifikatsiia rossiiskogo chastnogo prava, Statut, Konsul'tantPlius, 2008, pp. 5–34.

II. The Concept of Private Law in the Russian Federation

After the Socialist Revolution in Russia in 1917, the application of private law to property relations was rejected as a matter of principle. Private economic activity was not permitted except for personal needs. Major economic activity was conducted by state-owned enterprises within a centralized system and was regulated almost exclusively by acts passed at different levels of government. These acts provided mainly for imperative rules that had to be followed by all economic operators.

Economic transactions of a personal nature were subjected to legal regulation which was denominated as civil law, the main source of which was the Civil Code. In the Soviet legal system, civil law did not include Labour Law and Family Law: they were treated as independent branches of positive law based on separate acts of codification. Nevertheless some aspects of family and labour relations were subject to the rules of civil law.

The introduction of a new Civil Code into the Russian Federation had the modernization of the legal framework as its main goal to ensure effective development of market relations in the Russian national economy. To support the development of private law in the Russian Federation, the enactment of this legislative act also had to bring about the abandonment of the law and legal doctrine that served to support economic activities conducted through centralized system and regulated by mandatory rules.

But at the beginning of legal reform in civil law, the perception of private law dominant in the Russian legal community at that time was primarily associated with State withdrawal from direct involvement in economic activity and with the freedom of business activity for private persons. Russian legal circles did not assume normative parts of the private law concept to be anything very different from that practiced in the years of state dominated economy. It was thought that the same legal mechanism would be sufficient to regulate economic relations in a liberal environment.

Unfortunately, from the very beginning of the new legal order providing for free business activities, the fact that the normative part of private law in developed legal systems is mainly based on dispositive regulation had not been adequately taken into account. To put it differently, the level of self-regulation of participants in economic turnover as opposed to government regulation in private law was underestimated. That might be the main reason why legal reform in direction of developing private law had concentrated first and foremost on normative work that should produce the main legal source of private law – the Civil Code.

With regards to the system of legal sources addressing economic activities, an idea of introducing a unitary code was dominant from the start of civil law reform. Although the Russian legal system had usually been

attributed to a continental legal tradition where civil law as a rule was supplemented by commercial law in Russia, commercial law was not developed to be a separate branch of private law and numerous rules which regulated commercial activities had never been codified.

The separate codification approach, resulting in a set of legal rules for business transactions or for economic activities as a whole found no substantial support in the process of modern codification of civil law in Russia. This was mainly due to a desire to be in line with contemporary trends in the codification of private law in continental legal systems, showing an abandonment of private law dualism and combining all regulation of private law into one civil code like Switzerland, Italy, and the Netherlands. Another reason not to have a dual regulation of civil law was the feeling that the introduction of a "second code" could mean a return to the socialist concept of "economic law" (*chosyastvennoe pravo)* that denied the basic principles of private law.[10]

But it is also be worth mentioning that presently, the issue of a commercial (economic or entrepreneurial) code is presently still a point of academic discussion in Russia, and this question should not be considered as finally resolved. Due to reasons of different character, either juridical or political, periodic informal initiatives relating to adoption of commercial code have come up, and a debate around this topic is drawing the attention of those in legal, mostly academic, circles. In addition, numerous textbooks on commercial (economic, entrepreneurial) law are regularly published and these subjects are taught in the universities and law schools.[11]

In practice and legal literature in Russia, the term "commercial law" is used quite often to indicate rules of positive law applied to relationships of a commercial nature. There are a number of such rules in the Civil Code and other statutes addressing business activities. One of the basic ideas of the proponents of adopting a commercial code now is to accumulate all regulation relating to commercial activities in one act for practical reasons. But at the same time these proposals often do not pay much attention to whether the rules to be included in a commercial code represent private or public law.[12]

---

[10] See, e.g., V.A. Dozortsev, *Odin kodeks ili dva? (Nuzhen li Khoziaistvennyi kodeks nariadu s Grazhdanskim?)[One codification or two? (Is there a need for an Economic Code next to the Civil Code?)]* // Pravovye problemy rynochnoi ekonomiki/Institut zakonodatel'stva i sravnitel'nogo pravovedeniia pri Pravitel'stve Rossiiskoi Federatsii, M., 1994.

[11] See, e.g., *Kommercheskoe (predprinimatel'skoe) pravo. Uchebnik*, 4th ed., Prospekt, Moscow, 2009.

[12] See, e.g., B.I. Puginskii, *Kommercheskoe pravo Rossii. Uchebnik*, Vysshee obrazovanie, Moscow, 2005; *Aktual'nye problemy kommercheskogo prava. Sbornik statei*, 3rd ed., Zertsalo-M, Moscow, 2007.

As a matter of principle, the Russian Civil Code is applied both to commercial relations as well as to non-commercial relations. Since it is recognized that the former kind of activity objectively needs special regulation a number of rules that address these relationships are included into Russian Civil Code. In particular, they relate to arrangements that are generally characterized as commercial contracts or agreements.

In Russian civil law the core criterion with respect to that which in other legal systems is understood under the term 'commercial relationship' is the notion of entrepreneurial activity. The Russian Civil Code contains general definition of entrepreneurial activity as being an independent activity done at one's own risk and directed at the systematic receipt of profit from the use of property, sale of goods, performance of work, or rendering of service by persons registered in this capacity by a procedure established by a statute.

A remarkable feature of the Russian Civil Code in this respect is that rules addressing entrepreneurial activity in the Civil Code cover not only business relations between these persons but the transaction in which they participate as well, *i.e.* relations with non-commercial counterparts in the course of such activity. So, in some instances there are the same rules that apply both to business-to-business relations (B2B) and business-to-consumer relations (B2C). In other words the Russian Civil Code rules relating to entrepreneurial activities include the rules that apply equally to both commercial and consumer transaction.

Besides general rules in the Russian Civil Code that apply to consumer contracts there is a special legislation that addresses consumer protection in Russia. Among these legal sources, the most significant is the Federal Law on the Protection of Consumer Rights initially enacted in 1992, which has since been amended several times.[13] Consumer protection law is being developed within the boundaries of general civil law predominantly through the adoption of special legislation. It is necessary to underline that at present, effective implementation of consumer protection law in Russia is very much dependent on the actual situation in the market place. Currently, the situation with consumer goods in Russia still leaves much to be desired as compared with developed countries.

[13] Zakon Rossiiskoi Federatsii 7 February 1992 No. 2300-1 *O zashchite prav potrebitelei* v redaktsii zakona 23 July 2008 No. 160-FZ (sobranie zakonodatel'stva Rossiiskoi Federatsii 28 July 2008 No. 30 (chast' II) st. 3616.

III. Some Salient Features of the Russian Civil Code

In terms of legal technique, the new Russian Civil Code was primarily drafted along the lines of the continental legal tradition. As a matter of fact, starting from the end of the 19th century, civil law legislative practice and legal doctrine in Russia developed under the influence of German law. The drafters of the Civil Code had the advantage of studying the latest and most comprehensive civil law codification taking place in Germany at that time. In formulating the first Russian Civil Code in the prerevolutionary period, Russian drafters, who had mostly studied jurisprudence in German universities, in many instances used the same casuistic approach as in the German Civil Code. Some of the rules were worded very closely to German original.

Notwithstanding the different social and political conditions, the results of earlier draft codification works were used in Soviet Russia in preparation of the Civil Code. So, legal norms formulated in accordance with German pattern were transmitted into socialist civil law of Soviet Russia in the early 1920s. Codification of civil law that took place in the USSR during the following years continued this approach and many rules of RSFSR Civil Code (1964) showed a great resemblance to the German Civil Code, in particular, with regard to basic legal concepts, notions and institutions of civil law, such as transactions, legal persons, subjects and objects of rights, law of obligations, specific contracts.

The structure of the Russian Civil Code follows the pattern used in many European civil codes. This structure provides for a "General Part" stating general principles applicable throughout the Code. There is then a hierarchy of substructures dealing, for instance, with the subjects and objects of civil law rights, transactions, law of property, general rules of the law on obligations, general principles of contract law, and the specific details of particular contracts and non-contractual relations.

In contrast with the past, the new Russian Civil Code introduces legal concepts into the national legal system that support basic ideas and principles of private law.[14] So, it underlines the autonomy of the parties in forming their relationship and the dispositive nature of regulation in the Code. Also it contains numerous references to informal sources of regulation such as customs and trade usages. It defines a trade custom as a rule of conduct formulated and widely applied in any area of entrepreneurial activity regardless of whether or not it has been fixed in a formal way.[15] In

[14] See Art. 1 RSFSR CC "Basic Principles of Civil Legislation".
[15] Art. 5 RSFSR CC.

other words customs of commerce (or trade usages) are recognized as a source of law.

But the novelty of this provision for Russian civil law made it necessary to introduce some qualifications in its application. The problem of interrelation between a rule of positive law and trade customs is addressed in several articles of the Code. The general rule in Art. 5 provides that only trade customs not contrary to the mandatory provisions of legislation or, a contract binding upon the parties shall be applied. It may be concluded that if contractual term is not determined by the parties or by dispositive legal norm, that the relevant contract terms shall be determined by the customs of commerce applicable to the relations of the parties. So, it must follow from this provision that trade customs should prevail over dispositive rules of law.

However, in the general rules on contracts[16] it is provided that contract conditions shall be determined by applicable trade usage if not otherwise determined by the parties or by a dispositive norm. In other words, a dispositive rule has priority over trade custom. That approach seems to be inconsistent with the general approach which appears more consistent with private law. Obviously, the underestimation of the role of trade customs and usages was the result of the past practice and experience where informal regulation did not play any role in the economic activity of state enterprises.

Balance in the regulation of this issue was achieved through the rules for specific contracts. For instance, in accordance with the provisions of the Civil Code relating to sales contracts, (non-mandatory) rules of the Code are to be applied to contractual relationships between the parties only in the absence of trade usage.[17] This solution was adopted to follow the regulation concerning the application of trade usages as provided in the UN Convention on International Sale of Goods (Vienna, 1980)

Another important issue for the application of civil law rules addressed in the Code is the problem of gap-filling. The Russian Civil Code determines[18] that in instances where civil law relationships have not been expressly regulated by legislation or by agreement of the parties and there is no relevant trade usage, civil legislation regulating similar relationships shall apply insofar as this is not contrary to the essence of the relationship itself ("analogy of *lex*"). Where it is impossible to use analogy of *lex,* the rights and duties of the parties shall be determined by general principles and the sense of civil legislation (analogy of *jus*)*,* and by the requirements of *good faith, reasonableness* and *justice.*

---

[16] Art. 421 (5) RSFSR CC.

[17] See Chapter 30. Purchase and Sale (Arts. 454–566 RSFSR CC).

[18] Art. 6 RSFSR CC.

The last part of this provision represents quite a substantial novelty in Russian civil law as Soviet law rules had never used a reference to this kind of abstract criteria before as they were considered to be too vague and misleading. Now the Code contains quite a number of particular rules in which make express reference to *good faith* and *reasonableness*.

When speaking of general attitudes to new civil law in the Russian legal community, it has to be understood as reflecting their conceptions of private law. It is important to note that an understanding of the dispositive nature of new civil law at the present time is still alien to the legal awareness of a major part of Russian legal practitioners. They were educated and practiced law in very different conditions, where civil law regulation was treated almost exclusively as imperative. This situation objectively creates difficulties in the application of new rules which provide for a more creative approach than in the past.

IV. Influence of International and Foreign Legal Sources on Modern Codification of Private Law in the Russian Federation

As indicated earlier, the adoption of the new Civil Code in Russia laid the foundation for the transition of the national legal system to private law principles that was especially important for regulating economic activities in new, post communist environment. Unlike legislative work usually done in the course of the natural development of legal order, i.e. without systematic changes of the kind that took place in Russia in 1990s, the drafters of the new Russian Civil Code were deprived of the privilege to use mostly domestic experience as regards private law due to the historical reasons mentioned earlier.

Objectively, the process of drafting a new legal framework for market relationships meant an inevitable taking advantage of legal developments internationally and in other national systems where institutes of private law had been applicable in order to most effectively and successfully serve social needs. In the process of drafting the present Russian Civil Code, great attention has been paid to current developments in major foreign legal systems. The role of comparative law studies in this work should not be underestimated. A considerable number of rules in the Russian Civil Code had been drafted taking into account modern trends and tendencies which could be found in contemporary private law in foreign countries. In the first place national legal systems falling under the continental civil law tradition were considered by the drafters of the Code. At the same time great attention was paid also to the private law of those countries that represented another legal approach, *i.e.* national jurisdictions based on *com-*

mon law tradition. The latter was mainly studied in the commercial context.

A substantial part of the analytical work was connected with the study of international sources. In this respect it would be useful to mention that one of the fundamental provisions of the new Russian Civil Code[19] provided that "generally recognized principles and norms of international law and international treaties of the Russian Federation are a constituent part of the legal system of the Russian Federation". It is no less important to say that this article of the Code replicates Article 15.4 of the Constitution of the Russian Federation.

In the first place, the attention of the drafters of the Russian Civil Code was focused on products of the main international bodies involved in the unification of private law, namely the UN Commission on International Trade Law (UNCITRAL) and International Institute for the Unification of Private Law (UNIDROIT). It should be noted that the Soviet Union and later the Russian Federation actively participated in the activity of these organizations supporting the work of legal unification to facilitate international cooperation.

For this reason, it is surprising to find one of the key influences among international sources on the codification work of civil law in Russia was the UN Convention of International Sale of Goods (Vienna, 1980) – CISG. A number of solutions adopted in the Code relating to sale of goods were prompted by corresponding regulation in CISG. The most significant of such rules include, for instance, the definition of the quality of goods[20] and the timeframe for the discovery of defects in goods.[21]

The role played by CISG in the Civil Code drafting work was not exclusively limited by influencing specific rules on regulation of the contract of sale. Some norms from the general part on contracts also were drafted bearing in mind the approach adopted in the Convention. These provisions concern, for example, the definition of the price of performance,[22] definition of a fundamental breach of contract,[23] and the introduction of liability for the non-fault breach of contract made in the course of entrepreneurial activity.[24]

The UNIDROIT Principles of International Commercial Contracts were also consulted in the course of drafting work. This was done in spite of the fact that the Principles have a different legal nature and their legal text is

---

[19] Art. 7(1) RSFSR CC.
[20] *Cf.* Art. 35 CISG and Art. 469 RSFSR CC.
[21] *Cf.* Art. 39 CISG and Art. 477 RSFSR CC.
[22] *Cf.* Art. 55 CISG and Art. 424(3) RSFSR CC.
[23] *Cf.* Art. 25 CISG and Art. 450(2) RSFSR CC.
[24] *Cf.* Art. 79 CISG and Art. 401(3) RSFSR CC.

not a formal source of law. But bearing in mind the aims and legal content of the UNIDROIT Principles, *i.e*. to formulate "rules of law" which reflect accepted legal solutions accepted in the majority of national legal systems, the drafters of Russian Civil Code considered this international document to be an authoritative and convincing example of a widely supported private law approach to the regulation of business transactions. It is worth mentioning that both texts share not only basic legal concepts but are also very close on several specific issues, especially in the area of general contract law.

One of the examples of this similarity is the inclusion of the doctrine of substantial change of circumstances (hardships) in performance of the contract.[25] The corresponding rules of the Code indicate a close resemblance with the regulation of hardship in the UNIDROIT Principles.[26] It clearly demonstrates that UNIDROIT Principles are achieving one of their aims set forth in their Preamble, *i.e.* to "serve as a model for national legislators".

In this context it is also worth mentioning that the UNIDROIT Principles are quite well known to the Russian legal and business community because the text is available in the Russian language. They are quite often used by Russian business people in negotiating business contracts. Reference to the Principles in commercial practice also may be confirmed by the fact that the application of UNIDROIT Principles now plays a noticeable part in the practice of settling international commercial disputes in Russia. References to UNIDROIT Principles are to be found in awards of the International Commercial Arbitration Court at the Russian Federation Chamber of Commerce and Industry (MKAS).

The significance of this practice follows from the fact that today, MKAS is the major international arbitration institution in post-Soviet territory. The 1993 Russian Law on International Commercial Arbitration is based on the UNCITRAL Model Law of 1985. Article 28 (1) of the Model Law, which provides that "[t]he arbitral tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute" has been reproduced in Article 28 (1) of the Russian Law of 1993.

It should also be noted that MKAS, which has been dealing with the vast majority of international commercial arbitration cases in Russia, in its rules offers parties to international commercial contracts the practicable solution based on Article 28 (1) of the 1993 Law. Quite often an arbitral tribunal, acting under MKAS Rules and applying Russian material law to settle the dispute, takes advantage of the relevant provisions in the UNIDROIT Principles to supplement Russian civil law when the tribunal

---

[25] See Arts 6.2.1–6.2.3 of UNIDROIT Principles.

[26] See Art. 451 RSFSR CC.

finds it appropriate, as the Russian Civil Code does not have a very comprehensive regulation of commercial transactions. This use of the Principles also serves the purposes stated in the Preamble.

As regards the transplantation of legal rules or institutions from foreign legal systems it should be stressed that this process did not mean merely copying a legal institution or sets of rules from a developed system into the Russian code. In the modern codification of Russian civil law the analysis of developed national systems of private law and comparative studies played an important role. In assessing the suitability of particular foreign rules for inclusion into the new codified act, the drafters of the Russian Civil Code proceeded from the basic understanding legal rules, particularly those from developed national legal systems had been formulated in light of longstanding previous practice.

Therefore, almost every legal mechanism within a donor legal system reflected some elements of the legal history, culture and traditions of that system. The issue of compatibility of newly formulated rules with the legal structure, court practice and legal doctrine formed in the past years was always one of the most important topics in discussions relating to the possibility of adopting solutions from other legal orders where they were applied successfully. Great attention also was paid to the expectations and preparedness of the rapidly developing Russian business community to regulate its activities.

In deciding the problem of whether and to what extent it would be worth using a concrete legal approach in dealing with particular situations in the new codification, the degree of economic development in the country where the particular legal transplant had been functioning needs to be considered. This is especially significant in areas where there is no previous regulation or practice in recipient legal system. Since the level of economic development in Russian Federation differs from developed countries, in the process of drafting work on the Russian Civil Code not a single rule or set of rules originating in developed legal systems was formulated without some adjustment, sometimes quite substantial, in order to make it fit into the Russian legal system.

The adjustment of legal institutions from donor legal systems which were considered most appropriate for the Code was usually done from the viewpoint of legal technique, conceptual and objective conformity. But it is important to underline that the nascent economic relationship led to the employment of an unconventional and abstract assessment of the differences between the economic environment in the donor system and the Russian legal system. Additionally, through the major period of drafting the Code, it was very difficult to foresee the unexpected speed of the development of business activity in Russia in the following years.

The analysis of the application of new law in practice that took place after the adoption of the new Russian Civil Code helps formulate some general conclusions in respect to the use of legal transplants for transition economies where private law has not been developed or applied at all.

- Utilizing more advanced legal formulas, as a matter of principle, represents quite a positive development as they usually reflect higher level of legal practice, theory and technique. To a great extent, this could save recipient legal systems time and effort in creating regulations adequate for managing economic and social development substantially affected by global processes.
- Legal transplants are more efficient in areas where they reflect modern developments in domestic economic activity, not closely connected with traditional attitudes or deeply rooted in legal culture.
- Legal rules based on foreign law transplants could be used more successfully in the recipient legal system if they are formulated in a manner that allows their continuous adaptation. This adaptation depends heavily on how they are understood and implemented by domestic courts with education and expertise in a completely different legal culture and accustomed to less sophisticated legal environment.
- Those legal transplants which are of interest for developing private law systems involve something which might be called legal "fine-tuning" of existing legal orders. In their original form often they are not the results of legislative formulations but evolve rather from court and commercial practice. The courts in a recipient country are not familiar enough with the new commercial practices which usually develop more dynamically than the legal regulation. That puts the courts in difficult position in implementation of the rules formulated with regard to ideas imported by way of legal transplant.

V. Administration of Justice Relating to Application of Private Law

Since the most dramatic changes of Russian civil law took place in the area of regulation of economic activities, Russian judges with jurisdiction over economic (commercial) disputes met considerable difficulties in court practice during the initial period of application of the new provisions. One of the main reasons for this situation was that, during the initial period of application of new Civil Code provisions, Russian judges could not find the necessary guidance in previous court practice, due to the lack of jurisprudence in private law matters. This is hardly surprising as that practice

actually never existed during the Soviet era. Undoubtedly, this situation was an objective and logical consequence of the formal introduction of private law principles into current economic practice which were fundamentally different to the previous legal period. The courts were just not acquainted with private business activity and its legal treatment.

The courts, in many instances, continued to rely on their outdated understanding of civil law as a system which did not allow wide autonomy to private persons in forming their business relationships. They continued to consider civil law rules as mandatory unless the opposite is expressly indicated in the rule itself. In other words, without much guidance in applying the new rules, court practice in Russia continued under the influence of the previous experience of judges, and, to some extent, even resulted in the incorrect application of new law.

Another aspect which must not be ignored in assessing the situation with post-codification legal practice relates to specific features of the Russian court system. In the Russian Federation, jurisdiction over commercial disputes is vested with *arbitrazh* courts. This branch of the present Russian judiciary exists independently of the courts of general jurisdiction and had a special adjudicating system called *state arbitrazh* as its Soviet-era predecessor. These represented *quasi*-courts that had been dealing exclusively with dispute settlement between state enterprises within the centralized economy for many decades. In the Soviet era these institutions were in fact a part of the government and quite often did not settle economic disputes to the benefit of one of disputing parties, but rather in the interests of the whole national economy. So, the lack of experience in dealing with commercial disputes in an adversarial system of justice may be cited as another critical aspect of court practice in Russia which contributes to deviations in the correct application of private law rules.

The previous experience and vast inertia of the experience of law application accumulated in previous decades of dispute settlement within centralized economic system objectively had a great influence on the way in which new Russian private law rules would be interpreted and applied by *arbitrazh* court judges. Business-friendly judgments are still infrequent. Narrow interpretation of the principle of freedom of contract leads to a practice of refusing to accept commercial arrangements which are not directly addressed in the law. Where doubt arises, the courts tend to decide in a way which limits the parties' freedom of contract. Obviously, this attitude would be harmful to the adequate application of the Civil Code rules for on-going business practices until the judges of *arbitrazh* courts have accumulated enough relevant experience relating to business transactions in a market environment.

Current court practice in a number of cases also demonstrates that the Russian judiciary has been very reluctant to apply abstract criteria like *good faith* or *reasonableness* in dealing with commercial disputes and tends apply rules which often do not meet the practical expectations of business partners. In fact, the implementation of provisions referring to abstract criteria like notions of *good faith* or *reasonableness* have become the most problematic area. This is due to the fact that Russian judges and lawyers in general were familiar with such legal formulas, but not accustomed to applying these legal techniques and flexible rules in concrete situations which they were supposed to address in the context of business activities.

It is necessary to point out that the lower court practice, which had been extremely unstable and inadequate in the first years of after the adoption of the Civil Code, has indicated a visible improvement in the quality of application to commercial law matters in recent years. The important role in the process of making court practice more predictable and transparent is played by the Highest A*rbitrazh* Court of the Russian Federation, empowered by Constitution of Russian Federation to ensure the uniformity of law application in the field of economic relations. This function is realized by way of sending the lower courts information letters relating correct application of particular legal norms of the Civil Code and implementing legislation.[27]

These letters present solutions based on an analysis of current court practice. Almost all the main topics of civil law regulation relating to business activity are covered, giving them a very significant role in *arbitrazh* court practice due to the common conception that they constitute an informal guidance for all *arbitrazh* courts.[28] In legal practice and doctrine, the position of the Highest *Arbitrazh* court on specific legal issues is treated as official interpretation of existing legislation and is quite extensively studied as supplementary materials on positive law.[29] In very rare cases, the lower courts very reluctantly deviate from the interpretation of particular rules suggested by the highest courts.

In fact, the solutions suggested by the highest court to lower courts effectively reflect problems and contradictions relating to the application

---

[27] For a compilation of these documents see L.A. Novoselova, M.A. Rozhkova (Ed.), *Praktika rassmotreniia kommercheskikh sporov: Analiz i kommentarii postanovlenii Plenuma i obzorov Prezidiuma Vysshego Arbitrazhnogo Suda Rossiiskoi Federatsii*, Vypusk 3, Statut, 2008.

[28] See, for example, Prezidium Vysshego Arbitrazhnogo suda Rossiiskoi Federatsii. Informatsionnoe pis'mo from 21 December 2005 No. 104. *Obzor praktiki primeneniia arbitrazhnymi sudami norm Grazhdanskogo kodeksa Rossiiskoi Federatsii o nekotorykh osnovaniiakh prekrashcheniia obiazatel'stv*.

[29] See, *Praktika rassmotreniia kommercheskikh sporov. Analiz i kommentarii postanovlenii Plenuma i obzorov Prezidiuma vysshego Arbitrazhnogo Suda Rossiiskoi Federatsii*, Vypuski 1-3, Statut, Moscow, 2007.

of the private law norms of the Russian Civil Code, which in reality are still exposed to a transitional social-economic environment. It might be said that the present law is an emerging private law of transitional character. Its main role and purpose in the emerging market economy in Russia is to create a coherent legal treatment for business activities by combining radically different legal approaches originating from the past, on the one hand, and evolving from present practice, on the other.

But, obviously improving legal certainty and stabilizing court practice can be achieved only by means of transparent and foreseeable legal standards for business relations. It would not be a great overestimation to suggest that this process will continue for a considerable period of time into the future and may require successive generations of Russian lawyers.

VI. Current Phase of Private Law Development in Russia

The contemporary practice of applying the Russian Civil Code has revealed serious problems leading to instability and uncertainty in the process of ensuring commercial justice. In turn this situation creates obstacles for successful implementation of economic reform in Russia. Also, to a great extent, it undermines the positive role of codification based on private law principles undertaken during recent years. Rapid development and diversification of economic relations within Russia and its integration into world trade and investment processes reinforced an urgent need for the introduction of corresponding amendments which would addresses new economic and legal developments. Besides that, current practice has proven that the existing rules of the new Civil Code in many instances have not been detailed enough to guide courts and business practices in the right direction.

These circumstances have provoked an important political decision which plays a vital role in the further development of civil law in Russia. Consultative and scientific bodies attached to the Office of the President of the Russian Federation – The Council of the President of the Russian Federation on Codification and Perfection of Civil Legislation – came out with an initiative concerning the further development of the Code in view of changing legal and economic conditions in Russia and worldwide. This initiative was supported and the President of the Russian Federation announced the Decree "On Perfection of Civil Code of the Russian Federation".[30] It is worth stressing that, for the first time in Russian modern his-

[30] Ukaz Prezidenta Rossiiskoi Federatsii from 18 July 2008 No. 1108 *O sovershenstvovanii Grazhdanskogo kodeksa Rossiiskoi Federatsii. Sobranie zakonodatel'stva Rossiiskoi Federatsii from 21 July 2008.*

tory, the question of civil law development was decided on at the highest state level.

As stated in the Decree the main goal of this decision is to improve the legislative background for the market economy. The purpose of the work to be performed in accordance with this decision should provide legal support for international economic relations and humanitarian ties in the Russian Federation. The results of the work should materialize through prepared amendments to the Civil Code.

The first step in realization of the Decree was to prepare the Concept for the Development of Civil Law in Russia, the foundation for drafting federal laws to amend the Civil Code in the 2009−2011period. The Decree provided some basic requirements that the Concept should meet. They included the following:

- further development of the fundamental principles of the Russian civil law in accordance with a new level of market relations in Russia,
- reflecting the experience of court practice in its application and interpretation of the Code,
- harmonization of Russian Civil Code provisions with the rules regulating corresponding relations in EU,
- incorporation of positive experiences resulting from the modernization of civil codes of European states into Russian legislation,
- supporting a uniform regulation of civil relationships in the Commonwealth of Independent States (CIS)
- achieving stability in civil legislation in the Russian Federation.

The most prominent Russian legal scholars, judges, legal practitioners were involved in the work to prepare this document. The work on the Concept was completed and it was presented to the President of Russian federation on 1 June 2009. Before it was officially presented it was opened for public debate giving academic and practicing lawyers the opportunity to participate in the process.

The final version of the Concept[31] includes several sections which contain conceptual suggestions relating to the following topics: general provisions of the Code, legal entities, property rights in things, real estate property rights, general rules on obligations, negotiable instruments and financial transactions, intellectual property rights, international private law. When the Concept is officially adopted it will be sent to the Government as a basis for the preparation of drafts for concrete amendments and new provisions of the Civil Code.

Apart from this analysis of current Russian court practice and legal doctrine, great attention was paid to international and foreign sources of

[31] Russian text of the Concept see <http://privlaw.ru/>.

information about modern developments in the sphere of private law during the course of preparation of suggested amendments and additions to the Civil Code. Among them are documents produced by UNCITRAL, UNIDROIT, legal innovations in European Union member states relating to the reforms of civil and commercial codes (Germany, France) as well as the provisions included in Draft Common Frame of Reference (DCFR). Legislative proposals found in the Concept represent quite substantial changes to existing regulation in order to make it more efficient in dealing with the problems of modern economic life in Russia, most of which concern the formation and further development of effective market relations.

General Principles of Private Law in Ukraine

VOLODYMYR KOSSAK

The process of codification of private law in Ukraine has been a prolonged process. After the declaration of independence in 1991 there were still legislative acts from the former USSR in force in Ukraine, in particular the Civil Code of the USSR (1963) and the Code on Marriage and Family (1969). The structure and content of the Civil Code of the USSR of 1963 was determined by the administrative and centralized control system of governance under the USSR. It shaped how State property was managed, established a prohibition on private ownership over the means of production, and was characterized by an absence of the freedom of contract in economic sphere, restriction of physical person's civil rights in different spheres of social life (for instance, the circle of heirs at law was limited only to the second degree of kinship – sisters, brothers, grandparents) and many other aspects of legal affairs.

Although the Constitution of the USSR did provide for the right of a person to damages caused by illegal actions of state and law-enforcement bodies, the courts actually refused to take actions on such cases, justifying such a refusal with the absence of a special law.

Therefore, in the middle 1990's the work on the codification of private law began. It took 10 years and was done by drafting Civil, Family, Civil Procedural and other codes.

In the years between 2003 and 2005, private law in the Ukraine was fundamentally re-codified and innovated. In particular, on 1 January 2004 new Civil and Family Codes of Ukraine entered into force. The main purpose of the new Civil Code was to establish and protect private non-property and property rights on the basis of legal equality, the free declaration of intent, and the economic independence of the participants of legal relationships. The structure of the Civil Code is predominantly influenced by the Roman-Germanic law system. The Civil Code has a pandect structure and consists of six books. The first book, titled "Common Questions", lays out the common legal norms for the following five books where special questions are regulated. The first book regulates the basic principles of

relationships between subjects of civil law (i.e. between natural and legal persons as well as between such categories of persons among themselves) and the legal forms for the participation of the State and state authorities in civil law legal relationships, based on their legal equality. Among other common questions, there are legal norms, which regulate the origin and realization of civil rights as well as forms for their protection. Book 2 is dedicated to the regulation of personal non-property rights for physical persons, which are divided into personal non-property rights securing natural rights of a physical person and personal non-property rights securing social rights of a physical person in the Civil Code.

Book 3 is called "Law of property and Other Real Rights", Book 4 goes under the title of "Law of Intellectual Property", Book 5 is dedicated to Obligatory Law and Book 6 to Inheritance Law.

The Family Code, affirmed on January 10, 2002, came into force at the same time as the Civil Code of Ukraine of January 1, 2004. The Family Code of Ukraine provides grounds for marriage, regulates personal non-property and property rights and the duties of spouses, the basis for and content of personal non-property and property rights and the duties of parents and children, natural and adopted, and other family members.

According to the Code, the courts have a central function in providing the legal protection of rights. In Ukraine, courts of general jurisdiction examine private disputes between natural persons. There are different ways of defending civil rights and interests, namely:

1. the recognition of a right;
2. the recognition of a contract as void;
3. the preclusion of acts which violate a right;
4. restoration of rights, i.e. putting a party in a position corresponding to that before violation of its right;
5. compelling specific performance of an obligation;
6. changing a legal relationship;
7. the reparation of damages;
8. the termination of a legal relationship;
9. the compensation of moral damages;
10. invalidation of decisions by the court, or failure to act by public authorities or officials.

The last category, involving public authorities or officials as the respondents, is dealt with by administrative courts.

According to the Ukrainian Law "On Judicature" the court system in Ukraine consists of:

1. local general courts: district, city-district and local city courts and also court martial of garrisons;
2. courts of appeal;
3. superior specialized courts – the Supreme (or Superior) Court of Special Economic Jurisdiction of Ukraine and the Supreme (or Superior) Administrative Court of Ukraine;
4. the Supreme Court of Ukraine, which is the highest judicial body in the general court system of Ukraine, also in relation to specialized courts.

The basic statutory acts in Ukraine regulating civil procedure are the Constitution of Ukraine, the Law "On Judicial Procedure" and the Code of Civil Procedure of Ukraine. The Code of Civil Procedure of Ukraine was approved by a Statute on 18 March 2004 and entered into force on 1 September 2005. Also on the same day, the Code of Administrative Court Procedure of Ukraine entered into force. Before these two codes entered into force, there was only one Code of Civil Procedure in Ukraine (of 1963), which regulated both civil and administrative disputes. Legal disputes between legal persons or with the participation of individual entrepreneurs are resolved by courts of special economic jurisdiction, acting under the Code of Economic Procedure of Ukraine.

On 1 January 2004, together with the new Civil Code, a new Economic Code entered into force. Its purpose is to govern the relationships between entrepreneurial subjects ("enterprises"). The Economic Code establishes legal norms regulating the legal status of enterprises, including companies, enterprises and other kinds of business. The Economic Code of Ukraine also addresses the formation and registration procedures for commercial subjects; basic principles of commercial competition and economic activity with an international dimension; regulation of capital investments; and the basic aspects of bankruptcy. Apart from the legal norms of the Economic Code, relevant questions are also regulated by special Statutes: for example, by the laws "On State Registration of Legal Persons and Individual Entrepreneurs", "On Companies", "On Joint-Stock Companies", "On the Procedure of Foreign Capital Investment", "On International Economic Activity" etc. A large number of legal norms in the Economic Code regulate commercial contracts, including the contracts of "delivery", capital construction and freight.

The regulation of legal relationships under the civil legislation of Ukraine is based on the principle of the equal legal status of participants and protection of violated rights and interests. This is shown by many provisions, concerning the legal capacity of physical and legal persons. The legal capacity of legal entities has a general, rather than specific nature.

They have the right to enter into any entrepreneurial activity, although the Economic Code and other specific legislation have established a duty to obtain a license (permission) in order to be able to enter into some specific kinds of entrepreneurial activity, e.g. transportation, medical practice, educational services etc.

This approach in private law also has an important place in the field of property relations. The Civil Code provides for equal legal regimes for private entities, the State and for bodies of local self-government. The same is true for the protection of proprietors' rights. Protection is provided through similar means in legal tradition: vindicatio rei and actio in rem, acknowledgment of ownership rights in property, avoiding an act of a body of state power by which a property right was infringed and compensation of harm.

Principles of private law, such as the principle of freedom of disposition, are clearly shown in the contract law of Ukraine. In particular, contract law is dominated by the principle of freedom of contract, according to which parties are free to conclude a contract, to choose the other party to a contract and to define the terms of their contract, taking into account the requirements of the law, trade usages, as well as requirements of cleverness and justice.

The state does not, in principle, have a prevalent function in economic relationships as a party to a contract. However, State orders are obligatory for entrepreneurial activities which belong to the State or in which state property makes-up more than half of the chartered capital. Furthermore, State orders are also obligatory for entrepreneurial activities based on private property if they have a monopolistic position on the market. However, contracts concluded on the basis of obligatory State orders have become quite a rare phenomenon in recent times. In most cases, contracts for the purchase of commodities for State facilities, or contracts with the State for works or services are concluded on the basis of tenders won by the party offering the most advantageous terms of contract.

The legislative regulation of contractual relationships under the new Civil Code of Ukraine is characterized by an absence of detailed regulation of their content. In practice it is usually sufficient for the parties to reach consensus concerning the subject matter of the contract: the kind of commodity, the exercise of a particular works, provision of particular services etc. All other terms, for example, the date or the price in the case of a dispute between the parties could be inferred from market practice. Quite a different approach is taken, however, by the Economic Code, which requires that the determination of the subject-matter, the price and the date for delivery etc. are necessary substantial terms for economic contracts.

Liability for the parties for non-performance or improper performance of a contract results in an obligation to reimburse losses and the payment of forfeit (fines). Losses may consist of real losses of the creditor, losses which he or she suffered as the result of non-performance of the contract, or lost benefit. Forfeit and similar kinds of fine are determined by law or contract as a money sum, or in kind as movable and immovable property, which are to be paid by the party in breach of contract.

Contractual relations, in principle, are based on the private interests of the parties and their will. The State takes on a greater influence through legislation in the fields of international economic and investment relationships. In particular, export and import contracts concerning some kinds of commodities may have to be concluded within the framework of quotas, specific to the traded commodities. Temporary prohibitions or other sanctions on the carrying out of foreign economic activity or specific operations may also be imposed on Ukrainian parties to international economic activity for violation of legislation.

Detailed regulation is also specific for matters of foreign investment based on investment contracts. The law of Ukraine "On the Legal Regime of Foreign Investment" allows for different forms of foreign investment. Among them, the most widely-spread forms are the creation of enterprises with foreign investment and the realization of foreign investments on the basis of investment agreements (contracts). Such agreements are subject to registration with the Ministry of the Economy of Ukraine. Import of foreign investments on the basis of agreements without payment of a duty is only permitted with a registration card.

As a final point, the legislation of Ukraine in the sphere of private international private relations has also been recodified in recent times. The growing intensification of international private relations led to the need to create a special legal act in this field (Law of Private International Law). Disputes between foreign physical and legal persons are considered by the courts of general, economic and administrative jurisdiction. Parties can agree to have disputes in the sphere of external trade relations and foreign investment heard by international commercial arbitration, e.g. at the International Commercial Arbitration Court at the Chamber of Trade and Industry of Ukraine. This has one significant disadvantage, namely the use of the principle of reciprocity for recognition and execution of decisions of foreign courts, which, as a rule is based on international agreements. Ukraine is not a party to the multilateral conventions binding the European community. Only some bilateral agreements on legal relations and judicial assistance, which also provide for recognition and execution of judgments, have been concluded with specific member countries of the European

Union. Certainly, the recognition and execution of decisions of foreign courts is possible on a reciprocity basis without an international treaty having been concluded. But to our mind, regulation of this issue in international multilateral or bilateral agreements, which determine the procedure of acknowledgment and fulfillment of decisions as well as grounds for refusal of its acknowledgment, would be more expedient. With relation to international commercial arbitration, Ukraine is a party to the European Arbitration Convention of 1961 and to the New York Convention of 1958 which provides some regulation for international recognition and execution.

There is a dual system of regulation for private relationships in Ukraine – incorporating a civil and an economic nature, as seen in the existence of the Civil and Economic Codes, the basic codified acts of private law. The Civil Code and the Economic Code correlate as general and special normative acts. The problem of application for both adopted Codes arises in that certain groups of private norms, in particular contract obligations, are also included in the Economic code.

A characteristic of private law in Ukraine is the current trend towards harmonization, standardization with the law of other countries, including the countries of the European Union. The recent reforms of private law in Ukraine were carried out in light of EU directives, modern codifications of legislation for countries in the European Union, recommendations of the Roman Institute of Unification of Private Law and international agreements. The result of this is a remarkable unification of private law in Ukraine which satisfies the legal requirements and traditions for building a civil society.

Unification of private law and its harmonization are one characteristic of contemporary conditions. Law-making to this effect was carried out by aligning the legal regulations for private relationships with the traditions and requirements of legal doctrines and systems of the European States, in particular members of the European Union. This harmonization took place, in particular, within the scope of the Agreement between Ukraine and the European Community on the harmonization of Ukraine's legislation with the law of the European Union.

Contract Law in Serbia

JELENA PEROVIĆ

I. Brief Historical Survey

The contract law of Serbia has always been a part of the European, civil law family, based on the tradition of Roman law.[1] In the regions which later became the Kingdom of Yugoslavia, the codifications of the private law of European countries were adopted in 19th century as the prevailing law. In Slovenia and Croatia this was the 1811 Austrian Civil Code; in Serbia the 1844 Civil Code for the Kingdom of Serbia – and Montenegro adopted an abridged version of the Austrian Civil Code in 1888, providing a civil law code based on the tradition of Roman law, with ingredients of customary law from that part of the country.[2] Consequently, the former Yugoslavia's private, i.e. contract law legislation already had all the cha-

[1] Generally about contract law in Serbia and former Yugoslavia: see Perović, S., *Obligaciono pravo*, Belgrade, 1990.

[2] Opšti imovinski zakonik za Crnu Goru, 1888.

racteristics of a system based on the European legal civilization founded on the pillars of Roman Law in the first part of the 19th century.

This legislation was thrown out of the Eastern European legal culture immediately after the end of the Second World War by the forcible imposition of communist ideas and practice and by the destruction of the legal and other institutions of civil society based on private property and market economy. As early as 1946 the Law on Non-validity of all Laws and Regulations Enacted Prior to 6 April 1941 came into force, which meant a complete abrogation of the law of the former Kingdom of Yugoslavia. This effectively repealed all civil law codes, although the courts continued to apply them as *legal rules*, where they were not contrary to the constitution and the laws of the new State. This situation continued until the enactment of the Law of Obligations as a federal law for the former Yugoslavia. The other parts of civil law (the general part of civil law including family law and inheritance law) were regulated by separate laws at the republic level while property, pledge and other real rights were covered by the federal law.[3]

II. The Law of Obligations

The Law of Obligations was enacted in the former Yugoslavia in 1978, and is still in force in Serbia as the Serbian law of obligations following amendment in 1993[4] While drafting the Law of Obligations,[5] aspects of domestic legal tradition and comparative law were considered, especially the Swiss Code of Obligations, which resulted in a law conforming with that of the civil law countries. In addition, the law takes into account the rules of Common Law to the extent those rules have had an impact on solutions adopted by the relevant international conventions, especially the 1964 Hague Uniform Laws – ULIS and ULFIS.[6] As a result, the Serbian Law of Obligations represents a modern codification, completely in line

[3] Law on Foundations of Property Relations (in Serbian: Zakon o osnovnim svojinsko-pravnim odnosima), "Official Gazette of SFRY" no. 6/80, amended in 1990 and 1996, still in force in Serbia as a republican law.

[4] Law of Obligations (in Serbian: Zakon o obligacionim odnosima), "Official Gazette of SFRY" No. 29/78, 26 May 1978. Modifications: "Official Gazette of SRY" No. 31/93.

[5] The formal title of this act is the Law of Obligations; however, since both in terms of substance and form, it represents a codification in the deepest meaning of the word, it is usually referred to in domestic legal terminology as the Code of Obligations.

[6] The Law took over many rules and solutions from ULIS and ULFIS. For more information, see Perović S., Predgovor. Osnovna koncepcija Zakona o obligacionim odnosima, Zakon o obligacionim odnosima, The Official Gazette of the FRY, Belgrade, 2002, pp. 3–106; Perović, S., (*supra* note 1) p. 30–78.

with the main contemporary sources of uniform contract law. Since this law is in fact a *Code* of obligations, confirmed at all academic and professional levels both domestic and international and as it was a predecessor of many solutions adopted in UNIDROIT Principles and Principles of European Contract Law, the basic solutions and principles shall be presented here.

The Law of Obligations, consisting of 1109 articles, regulates the area of obligations in two different sections. Part 1 (the General Section) relates to the basics of contractual relations, Part 2 deals with specific contracts. The General Section, in addition to general principles, contains provisions on the source of obligations (contract, tort, unjust enrichment, *negotiorum gestio*, unilateral expressions of will – public announcement of award, securities), the effect and termination of obligations, as well as the rules regulating different types of obligations and changes of party in contractual relationships. The general rules on contracts deal with the formation, validity, representation, interpretation, contents and effects, performance, non-performance, remedies in general, remedies for non-performance and termination of contract. Part 2 of the Law regulates specific contracts such as sale, barter, loan, lease, employment contract, deposit, *mandatum*, pledge, security, storage, commission, agency, shipping, intermediation, transportation of persons and goods, licensing contract, insurance, tourist contracts, assignment, settlement, and banking transactions – currency deposit, deposit of securities, savings deposits, current accounts, secured lending, secure, letters of credit and bank guarantees.

The basic principles of the Law of Obligations are *principles of party autonomy* according to which parties are free to enter into a contract and to determine its content, subject to the requirements of public policy, mandatory rules and principles of good faith and fair dealing as well as the *principle pacta sunt servanda* (binding effect of contract).

Principles of good faith and fair dealing have taken up considerably more space in the law than in some other codifications of comparative law. In addition to general rules establishing the principles of good faith and fair dealing, the law provides for this principle in numerous specific cases, e.g. extension of contractual liability, preliminary withdrawal of the right to terminate a contract, and the assessment of good faith of a party, implying many important legal consequences. The law also establishes equity as a deciding criterion in many cases: in the field of contract interpretation, for the termination or adaptation of contract due to a change of circumstances – *rebus sic stantibus* (hardship), in many cases of contractual liability (termination of construction contracts, *mandatum*, commercial agency contracts, general conditions of type contracts, etc.).

In addition to the principles of good faith and fair dealing and equity, the Law provides for the possibility of applying good usages and/or good trade usages. In this respect, the Law establishes *principle of good trade usages* as one of its general principles, and then specifies this principle as a general condition of typical contracts, for contract formation, offer and acceptance, test purchase, payment of rent in the contract of lease, commercial agency and intermediation, travel organization contract, etc.

One of the basic issues in the matter of contract law, in addition to principle of party autonomy, is that of acceptance and the application of the principle of conclusion of contract *solo consensu*. Since the *consensualism* is a principle of modern contract law in general, the Law of Obligations has incorporated this by providing that a contract is not subject to any requirement as to form, except as otherwise provided for by law. However, the historical development of contract law points out the fact that the principle of consensualism has never been implemented absolutely and that were always some exceptions where parties were obliged to respect legal requirements relating to form of contract (formal contracts). It is therefore possible to speak only of a more or less intensive effect of that principle in contract law, and of the "fluctuations" in formalism during various periods of its development. In recent decades a certain extension of formal requirements in comparative contract law became apparent which gave some authors cause to speak of a "renaissance of formalism".[7] In that regard, the Law of Obligations provides a certain number of formal contracts, e.g. construction, license, commercial agency, insurance, credit, bank guarantee.[8]

The *principle of equivalency* of bilateral contracts is given a special position among the general principles, protected in law by numerous rules including liability for material defects, liability for legal defects, *laesio enormis*, prohibition of usury contract, and the termination or adaptation of contract due to change of circumstances.

The Law of Obligations adopts the *principle of unified regulation of obligation relations* according to which its rules are equally applicable to all transactions that take place in the sphere of trade of goods and services.[9] As an exception to that principle, the law provides special rules for specific cases for commercial contracts, because the very nature of these contracts requires a particular legislative approach (including shorter deadlines, requirement of professional care, and the presumption of joint and several liability in obligations with two or more debtors, etc).

---

[7] See Perović, S., (*supra* note 1) p. 338–367.

[8] For further information about formal contracts in Serbian law, Perović, J., *Međunarodno privredno pravo*, Belgrade, 2008, p. 211–213 and 255–257.

[9] The same principle is adopted in the Swiss Code of Obligations.

The Law of Obligations adopts the *principle of a non-mandatory character* for its rules; parties may exclude the application of any of its provisions or derogate from or vary their effects, except as otherwise provided for by law. The law contains a limited number of mandatory rules, which are usual in comparative law and whose purpose is to secure a general framework of legal certainty in contractual relations.

Analysis of the Serbian Law of Obligations leads to the conclusion that it represents a well-developed and sophisticated system of contract law completely in accordance with requirements of contemporary market economy and modern trends in comparative law. As such, this Law may possibly be amended by new or modified rules which, however, should not disrupt its systematic and subjective coherence. The best evidence for this view is the comparison between the text and the Principles of European Contract Law that were drafted almost 20 years after the Law of Obligations came into force (1978). This comparison shows an essential similarity of many solutions, meaning that the Law is basically compatible with present-day requirements of the European Union involving the trade of goods and services in the common European market.

III. Particular Laws on Certain Contracts

The Serbian Law of Obligations regulates over 30 kinds of contracts. The characteristics and content of these contracts are standard and as such, frequent in practice. Contracts are regulated mainly by non-mandatory rules, so that contracting parties are free to enter into a contract and to determine its content according to principle of party autonomy, while statutory rules apply only where the parties do not decide otherwise.

For certain contracts regulated in general way by the Law of Obligations there are particular laws specifying their details (e.g. insurance, different types of transport of persons and goods, construction, contracts in tourism). The Law of Obligations applies as *lex specialis*. In that respect, it should be noted that consumer protection in Serbia is covered by the Law on Consumer Protection[10] which provides special rules related to certain types of distance sale contract[11] as well as to consumer credit contract.[12]

On the other hand, some contracts, due to their specific nature, are not covered by the Law of Obligations, being instead regulated by other, specific laws. Thus, for instance, contracts relating to the establishment of

[10] Law on Consumer Protection (in Serbian: Zakon o zaštiti potrošača), "Official Gazette of Republic of Serbia" No. 79/2005.

[11] Art. 24–28.

[12] Art. 29 and art. 30.

companies and corporate governance are regulated by the Law on Companies,[13] financial leasing contracts, by the Law on Financial Leasing,[14] the contract for a registered charge is governed by the Law on Registered Charges on Movable Assets,[15] and a concession contract by the Law on Concessions.[16]

IV. Contracts not Regulated by Law (*contrats innommés*)

A special issue in the contract law of Serbia relates to contracts that are not regulated by law (un-nominated contracts, *contrats innommés*) whose characteristics and content correspond to the general rules of contract law. These contracts may be validly concluded by parties in accordance with principles of party autonomy. Their content is determined by parties either through the combination of some elements of the contracts regulated by law or by stipulating entirely new content, independent of any other contract provided for by law.

Where a contract is regulated by law, parties do not have to regulate their relationship in detail. It suffices to reach agreement on essential elements of the specific contract so that the relevant statutory provisions apply to it. For innominate contracts however, as there are no statutory provisions which replace or supplement the parties' intention, the contract must be formulated with special care to ensure the parties' intention is expressed precisely, correctly and with no ambiguity. Where a dispute arises, the court/arbitration shall apply the general rules and principles of contract law as well as the rules relevant for similar contracts (analogy) regulated by the Law on Obligations. Generally, the most important national sources

---

[13] Law on Companies (in Serbian: Zakon o privrednim društvima), "Official Gazette of Republic of Serbia" No. 125/2004. More about the Serbian Law on Companies, Vasiljević, M. *Vodič za čitanje Zakona o privrednim društvima*, Belgrade, 2004; Vasiljević, M. *Kompanijsko pravo*, Belgrade, 2005.

[14] Law on Financial Leasing (in Serbian: Zakon o finansijskom lizingu), "Official Gazette of Republic of Serbia", No. 55/2003. For comments on this Law, see Perovic, J., *Financial Leasing in Serbia: an Overview of Recent Legislation*, Uniform Law Review, UNIDROIT, NS-Vol. X, 2005–3, p. 503–516; Perovic, J., *Komentar Zakona o finansijkom lizingu*, Belgrade, 2003.

[15] Law on Registered Charges on Movable Assets (in Serbian: Zakon o založnom pravu na pokretnim stvarima upisanim u registar), "Official Gazette of Republic of Serbia", No. 57/2003. For comments on this Law and the text of the Law in German, see Perovic, J., *Republik Serbien: Gesetz über Registerpfandrecht an beweglichen Sachen*, Wirtschaft und Recht in Osteuropa (WiRo), 2/2004, p. 46–55.

[16] Law on Concessions (in Serbian: Zakon o koncesijama) "Official Gazette of Republic of Serbia", No. 55/2003.

for contracts not regulated by law are: the contract itself as the first source, practices established by the parties between themselves, trade usages to which the parties have agreed, general principles in the field of commercial relations, general principles and rules of the national Law of Obligations and its specific rules relevant for similar contracts.

Some innominate contracts appear more often in commercial transactions. Continued practical application of these contracts over a longer period of time renders them as standard, they are given a title, become regulated by law, transformed into nominate contracts. The Law of Obligations regulates these "new" contracts, for example contracts on control of goods and services, some contracts in the area of banking transactions such as bank guarantees and the most common contracts in the field of tourism e.g. the contract on travel organization, intermediation in travel arrangements, allotment, etc.

However, quite a number of modern commercial contracts arising out of the *lex mercatoria* in Serbia are not regulated by law. Thus, for instance, contracts on distribution, franchising, time sharing, factoring, forfeiting, and technology transfer, as well as agreements for long term supply of goods, manufacture of goods, supply of services and other new commercial contracts are not regulated by the Serbian Law of Obligations. Nevertheless, these contracts may be validly concluded in accordance with principle of party autonomy subject to requirements of public policy, mandatory rules and principles of good faith and fair dealing.

In Serbian legal theory an intense discussion is going on as to whether new commercial contracts should be regulated by law or their development should be left to commercial practice. Different views are expressed regarding that question in comparative law. According to one author, these contracts should not be specifically regulated by law; instead they should be treated in the framework of the general rules of contract law. Another author stated contracts should be regulated either by special laws (e.g. financial leasing in Serbia[17]), as part of the law of obligations, or under the civil code, which in comparative law is not frequent as far as classical codes are concerned. According to a third view, regulation of these contracts should be left to corresponding international conventions and to the

[17] On reasons for regulating financial leasing by separate law in Serbia, see, Perovic, *Financial Leasing in Serbia* (*supra* note 14), p. 507, where the author states: "A special law was deemed necessary to ensure the uniform regulation of as many issues relevant to financial leasing transactions as possible. From the point of view of legal certainty, as well as from a practical standpoint, it makes more sense to regulate a particular legal institution in a single act than to adopt a piecemeal approach that might result in inconsistencies and conflict. Financial leasing is a highly specific transaction that requires uniform regulation".

ratification of acts by member states or to recommendation of the relevant international organizations and institutes in the form of model laws.

V. International Conventions and other Sources of Uniform Contract Law

1. Ratified international conventions

The ratified international conventions regulating on uniform way matters in the field of contract law are an especially important source of contract law. International conventions that have been ratified and promulgated constitute part of internal legal order and are directly applicable when conditions for the application of each specific convention are met. Serbia has ratified numerous international conventions that directly or indirectly refer to the sphere of contract law.[18] According to the Constitution of the Republic of Serbia, these ratified international conventions constitute part of internal legal order of the Republic of Serbia; they must not be contrary to the Constitution while laws and other legal acts must not contravene the ratified international convention.[19] Ratified international conventions in Serbia are published in the official gazette together with the promulgating act.[20]

2. The CISG – Ratification

UN Convention on Contracts for the International Sale of Goods (CISG) that applies to contracts for the international sale of goods is one of the most important international documents regarding the unification of contract law.[21] The former Yugoslavia signed and ratified the CISG on

---

[18] For the list of international conventions relating to contract law and private international law ratified by Serbia, see Stanivuković, M./Živković, M., Serbia, Supplement 21 (January 2009), International Encyclopaedia of Laws, Private International Law.

[19] Constitution of the Republic of Serbia, art. 16 and art. 194.

[20] Official Gazette of Republic of Serbia, International Treaties.

[21] For the CISG in general and for the sphere of its application see Schlechtriem, P./ Schwenzer, I., *Commentary on the UN Convention on the International Sale of Goods,* Second (English) ed. Oxford University Press, 2005; Bianca, C.M./Bonell, M.J., *Commentary on the International Sales Law, The 1980 Vienna Sales Convention*, Giuffrè, Milan, 1987; Neumayer, K.H./Ming, C., *Convention de Vienne sur les contrats de vente internationale de marchandises*, Commentaire, Lausanne, 1993; Honnold, J.O., *Uniform Law for International Sales under the 1980 United Nations Convention,* Kluwer Law International, 1999. See also, Heuzé, V., *La vente internationale de marchandises. Droit uniforme*. Traité des contrats sous la direction de Jacques Ghestin, Paris, 2000, pp. 74–117; Audit, B., *La vente internationale de marchandises, Convention des Nations-Unies*

11 April 1980 and 27 March 1985, respectively. On 12 March 2001 the former Federal Republic of Yugoslavia declared the following: "The Government of the Federal Republic of Yugoslavia, having considered the Convention, succeeds to the same, undertaking to perform faithfully and carry out the stipulations therein contained as from 27 April 1992, the date upon which the Federal Republic of Yugoslavia assumed responsibility for its international relations". The Constitutional Charter of Serbia and Montenegro Union (4 February 2003) provided for the transmission of all the rights and obligations of former Federal Republic of Yugoslavia to Serbia and Montenegro Union (art. 63). Furthermore, the Charter stated that, in case of separation of Montenegro from the Union, all international documents shall be automatically adopted by the Republic of Serbia as its successor (art. 60.4). On the basis of these rules, in Republic of Serbia the CISG is in force as of 27 April 1992.

3. Basic differences between the CISG and the Serbian Law on Obligations

The main differences between the Serbian Law on Obligations and the CISG lie in the concepts of a *fundamental breach of contract* and *non-conformity of goods*, as defined in the CISG.[22]

The CISG provides for the fundamental breach of contract as a basis for avoidance of contract.[23] The Serbian Law on Obligations, like many other codes in civil law countries, is unfamiliar with the concept of a fundamental breach of contract. Instead, it adopts the non-performance of contractual obligation as a general ground for the avoidance of bilateral contracts[24] on one side, and material and legal defects as special grounds for avoidance of a sale contract, on the other.[25] Nevertheless, both legal sour-

---

du 11 avril 1980, L.G.D.J., Paris, 1990, pp. 17–30; Ferrari, F., *La compraventa internazonale, Aplicabilidad y aplicaciones de la Convención de Viena de 1980*, pp. 81–176. In Serbian doctrine, Perović, J., *Bitna povreda ugovora. Međunarodna prodaja robe,* Belgrade, 2004; Perović, J., *La contravention essentielle au contrat comme fondement à la résolution des contrats dans les codifications de droit uniforme*, Revue de droit international et de droit comparé, Bruylant, Bruxelles, 2008/2–3, p. 272–307.

[22] One of the differences between the CISG and the Law of Obligations is related to the revocation of an offer. The CISG adopts the principle of revocability of an offer (with significant exceptions specified in art. 16) whereas under the Law of Obligations an offer is irrevocable; it may be revoked if the revocation reaches the offeree before an offer or in the same time as an offer (art. 36).

[23] See art. 25 of the CISG as general rule on fundamental breach.

[24] See arts. 124–132 of Serbian Law on Obligations as general rules on termination of contract due to non-performance.

[25] See arts. 478–515 of Serbian Law on Obligations on material and legal defects of goods in sale contract.

ces, regardless of the different concepts they use, start with the same criteria relating to the importance of non-performance, i.e. consequences of non-performance. In that regard, the basis for contract avoidance is not the non-performance of an obligation, but only a non-performance that substantially deprives the aggrieved party of the expected benefit under the contract and substantially impairs the entire purpose of the contract for that party. The main problem both systems face is how to evaluate the importance of a specific non-performance for the purposes of determining whether sufficient ground for contract avoidance exists.[26]

The uniform concept of lack of conformity as defined under the CISG is wider than the concept of material defects and includes not only differences in quality, but also differences in quantity, delivery of goods of different kind (*aliud*) and defects in packing.[27] On the other hand, the Serbian Law of Obligations, relying on the Roman-pandect categories, specifies the rules for sales contracts regarding material defects of the goods,[28] while the other cases of non-performance are subject to general rules on avoidance of contract due to non-performance. Nevertheless, specific cases of non-conformity defined under the CISG, such as unfitness for ordinary purpose of the goods, lack of fitness of the goods for a particular purpose and non-conformity of goods to a sample or model, largely correspond to the definition of material defects under the Law of Obligations. In addition, liability of the seller for non-conformity is dealt with almost identically under the CISG and the Law of Obligations' provisions dealing with liability of the seller for material defects, and those dealing with defects for which the seller bears no liability. Provisions of the CISG dealing with buyer's right to rely on lack of conformity are also similar to the relevant rules of the Law of Obligations. Based on the comparative analysis of these solutions, the conclusion seems to be that under both systems, it is not any defect that gives the buyer the right to avoid the contract, but only a defect that diminishes the expected benefit to the buyer and substantially impairs the entire purpose of the contract. Under the CISG, this principle is integrated under the definition of fundamental breach, whereas under the Law of Obligations, it is articulated through the rules on avoidance of contract for partial defects as well as through the general rule stating that a contract cannot be avoided for non-performance of an immaterial part of an obligation.[29]

---

[26] See, Perović, J., *Bitna povreda ugovora* (*supra* note 21), pp. 111–184.

[27] See art. 35 of the CISG as a basic rule regulating non-conformity of goods.

[28] See arts. 478–500 on material defects.

[29] See, Perović, J., *Bitna povreda ugovora* (*supra* note 21), p. 134–147, 195–200, 219–23.

4. Application of the CISG by Serbian courts and arbitration

Although the application of the CISG as a ratified international convention has priority over national laws, the courts of Serbia are not very familiar with its application even in simple cases of direct application specified in article 1.1.a. CISG. Generally speaking, courts of first instance do not, in most cases, apply the CISG at all; instead, judges determine the applicable law by virtue of the rules of private international law which usually means the application of Serbian substantive law under which they consider the Serbian *Law of Obligations* and *not the CISG,* although all the conditions for the application of the CISG are met.

In appeal proceedings the High Commercial Court expressed different views regarding the application of the CISG. For example, in a decision of the High Commercial Court of 7 February 2006,[30] the Court held that, when the seller is a foreign company and the buyer a domestic legal person, and both parties are from CISG Contracting States, the CISG and not the Law of Obligations must be applied to the contract of sale. Therefore, the application of the Law of Obligations to the contract by the court of 1st instance was wrong. A similar view is expressed in a decision of the High Commercial Court of 23 August 2004,[31] where the Court stated that, concerning international sale of goods, the relevant source of law is the UN Convention on the International Sale of Goods of 11 April 1980 (CISG). In this case, the CISG was applied to an international sales contract concluded between a party from Serbia and a party from Germany. The parties did not make a choice of law applicable to their contract and both parties were from CISG Contracting States: Yugoslavia (presently Serbia) which ratified the CISG in 1985, and Germany which ratified the CISG in 1989. The Court held that the relevant facts of the case led to the application of the CISG by virtue of art. 1.1.a or by virtue of art. 1.1.b, stating that a decision of the court of first instance regarding the application of national Law of Obligations as substantive law to the contract was wrong. The opposite view can be found in a decision of the High Commercial Court of 9 June 2004,[32] where the Court decided to apply the law of Serbia to a contract for the international sale of goods concluded between a party with the place of business in Slovenia and a party whose place of business was in Serbia. Since the contract did not contain a choice of law clause, the Court held that the parties implicitly expressed that choice by choosing the court in Serbia. The Court perceived the parties' choice of the court in Serbia as one of the main indicators of their intention to apply the law of Serbia as

[30] XVIII PŽ. 9326/2005.
[31] PŽ. 1937/2004/2.
[32] PŽ. 1006/2004/1.

the substantive law for their contract. On this assumption, the Court concluded that the decision of the first instance court to apply the Law of Obligations of Serbia as substantive law to the contract was correct.

In a comparison to regular court practice, the CISG is well known and widely implemented in Serbian arbitration practice. In most of the arbitration awards concerning contracts of international sale of goods from the 1998–2008 period, the CISG was applied in cases where the conditions of its application were met.[33]

5. Other sources of uniform contract law

In addition to ratified international conventions, other sources of uniform contract law are rather important in the development of contract law on Serbia as well. These sources include UNIDROIT Principles of International Commercial Contracts (UNIDROIT Principles) and Principles of European Contract Law (PECL),[34] non-ratified international conventions, model laws, standard clauses, model contracts, legal guides, instructions, recommendations and other documents adopted and recommended by the relevant international organizations, especially UNCITRAL, UNIDROIT and ICC.

The influence of UNIDROIT Principles and PECL on Serbian contract law relates first of all to the fact that contracting parties from Serbia, in concluding international commercial contracts have in recent years, began to stipulate their application either through a choice of law clause explicitly providing that a contract shall be governed by them (e.g. "This Contract shall be governed by the UNIDROIT Principles of International Commercial Contracts"), or by providing that a contract shall be governed by general principles of law or by *lex mercatoria*. Additionally, in some cases, in the reasoning of awards, Serbian arbitrators refer to UNIDROIT Principles or PECL.[35] Finally, certain solutions of UNIDROIT Principles

---

[33] Detailed analysis, Perovic, J., *The CISG in Serbia,* GTZ – UNCITRAL PROJECT: Regional implementation of the Convention on International Sales of Goods (CISG) and international arbitration rules (published by GTZ).

[34] Comparative analysis between the main solutions of the UNIDROIT Principles and PECL on the one side and those of the Serbian Law of Obligations on the other, Perović, J., ‚*Bitna povreda ugovora* (*supra* note 21); Perović, J., *La contravention essentielle* (*supra* note 21).

[35] These cases are still rather rare. See for example the award of International Trade Arbitration attached to the Chamber of Commerce of Serbia T-9/07, 23 January 2008 where the tribunal expressed the following view: "The arbitration tribunal considers that no important difference exists regarding damages due to non-performance of obligation from the part of the seller which he could foresee at the time of conclusion of contract as a reasonable person, independently on the legal basis to which the tribunal refers. All

and PECL and their comparative analysis with the relevant rules of the national Law of Obligations are intensively discussed in the doctrine of Serbian contract law, which is paying increasing attention to the sources of uniform law.[36]

The relevant international conventions not ratified by Serbia like the UNIDROIT Convention on International Financial Leasing, UNIDROIT Convention on International Factoring, and Convention on Agency in the International Sale of Goods (Geneva) have a significant role in the development of Serbian contract law, firstly as models for the national legislators in drafting new rules in certain fields of contract law or modifying the existing rules. In that regard, it should be noted that the UNIDROIT Convention on International Financial Leasing of 20 May 1988 (Ottawa) was the main source of the Serbian Law on Financial Leasing which came into force on 27 May 2003.[37] The Serbian Law incorporated many provisions from that Convention, especially with respect to the principal issues. Consequently, internationally accepted standards were integrated into the national legal system, compatible with the entire national legal system, the legal tradition and fundamental legal principles.[38]

VI. European Union Directives

The directives of the European Union are binding upon the Member States of European Union to which they are addressed. Member States are obliged to take the measures necessary to achieve the results set out in the directive but they are free to decide how to transpose the directive into national law.

At the time of writing, Serbia was still on the road to joining the Union so that one may only currently speak of the indirect influence of the EU directives on Serbian contract law. In any case, due to Serbia's prospective EU membership, the directives should be gradually transposed into national law. This should be achieved on a case-by-case basis, taking into account the nature, background and wording of each specific directive as well as the results to be achieved. This means that existing national legislation should be modified or national provisions enacted for harmoniza-

---

three documents – CISG, PECL and UNIDROIT Principles regulate this question on a similar manner" (Perovic, J., *The CISG in Serbia*, *supra* note 33).

[36] The list of publications on the CISG in Serbian, Perovic. *The CISG in Serbia*, (*supra* note 33).

[37] Law on Financial Leasing (in Serbian: Zakon o finansijskom lizingu), "Official Gazette of Republic of Serbia", No. 55/2003.

[38] Perovic, J., *Financial Leasing in Serbia* (*supra* note 14), p. 507.

tion. In the field of contract law, in that regard, directives related to consumer protection, electronic signature and electronic commerce in general are of special importance.

The directives of European Union related to contract law should be transposed into Serbian national law by enacting specific new laws or by-laws, together with appropriate changes to the existing relevant laws. According to the author, the text of directives *should not* be introduced in the Law of Obligations, especially not the integral texts. The influence of directives may be seen only as possible amendments to the Law of Obligations where necessary in order to adapt certain provisions of the law to the appropriate requirements of a specific directive. The Law of Obligations which represents a *permanent source* of the law of obligations and a specific monument of legal culture, should not be subjected to frequent changes, which is exactly the nature of directives that are swift to adapt to the dynamics of commercial relations. The objective of directives is not their transcription into national laws, but the adaptation of the national legislations of the Member States to solutions specified in the directives.

VII. The Civil Code of Serbia

Serbia is at present one of the rare countries with no Civil Code at the beginning of 21st century. This is a strange phenomenon, as it was one of the first European countries to have already adopted its Civil Code in 19th century (1844). Parts of civil law are presently regulated by specific laws: the Law of Obligations, Property Law,[39] Family Law[40] and the Law on Inheritance.[41] It is well known that codification of civil law *per se* increases the richness of legal culture and contributes to the stability of legal relations. In addition, it regulates the entire corpus of subjective civil rights in one place, which is especially significant for natural and legal persons as the holders of these rights.

Starting from the fact that drafting of the Civil Code is an important step to legal certainty and rule of law, and considering the present status of Serbian private law, its history and culture, the Government of the Republic of Serbia established the Commission for Drafting the Civil Code of

[39] Law on Foundations of Property Relations (in Serbian: Zakon o osnovnim svojinsko-pravnim odnosima), "Official Gazette of SFRY" No. 6/80, amended in 1990 and 1996.

[40] Family Law (in Serbian: Porodični zakon) "Official Gazette of Republic of Serbia" No. 18/2005.

[41] Law on Inheritance (in Serbian: Zakon o nasleđivanju) "Official Gazette of Republic of Serbia" No. 46/1995.

Serbia in 2006.[42] Eminent experts and authorities in the field of civil law were appointed to the Commission and Professor Slobodan Perović was appointed president. The Commission started its work on 26 December 2006 and the drafting procedure of the Civil Code is in progress.

The Commission has published a report under the title "*Work on the Drafting of Civil Code of the Republic of Serbia*" in 2007, where it presented its work in 400 pages, together with open issues relating to the Code.[43] As stated in the report, the work on drafting the Code is made considerably easier by the fact that some laws in the field of civil law, like for example the Law of Obligations, are already at the high end of legal culture. However, the Commission emphasises that drafting the Civil Code must not be reduced to a simple reception of existing particular laws in the field of civil law and their technical formulations in the form of codification. This work includes firstly, an analysis of the existing legislative solutions, their modernization and development, and particularly their harmonization, both between themselves and with the most common solutions and trends in comparative law. This means it is necessary to harmonize the corresponding legislative solutions with those adopted in ratified international conventions as well as with other international and particularly European standards. The future Civil Code of Serbia should meet two basic requirements: to further develop the rules in the sphere of private law promoting the principle of legal certainty and the rule of law, while at the same time not closing the road to the further evolution of civil law and its continuous improvement.[44]

VIII. General Conclusion

Analysis of relevant sources of contract law and particularly the Law of Obligations and its central solutions and principles, the significant influence of international conventions and other sources of uniform contract law on the development of Serbian contract law reveals that it is a liberal, well developed, modern and progressive part of Serbian private law. Future codification in the form of Civil Code, is continuing the process of complete harmonization with the standards of European legal science and European legal civilization.

---

[42] Decision on the Establishment of the Commission for Drafting the Civil Code of Serbia (in Serbian: Odluka o obrazovanju Komisije za izradu Građanskog zakonika), "Official Gazette of Republic of Serbia" No. 104/06 and 110/06.

[43] Rad na izradi Građanskog zakonika Republike Srbije, Izveštaj Komisije sa otvorenim pitanjima, Belgrade, November 2007.

[44] *Ibid,* pp. 18–19.

Contract Law in Romania

CAMELIA TOADER*

I. Foreword

Over the past 150 years, legal transplants have played an important role in setting the legislative foundations of Romanian private law, although complex factors worked together to shape an original legal system, with its own values and principles.

The Romanian legal system is a mixture of legal transplants and original solutions. Forged on the basis of the XIX century codifications, Romanian private law was significantly influenced by socialist legislation, especially in the fields of family, labour and property law. The fact that the Civil and Commercial codes remained in force allowed a swift return to the fundamentals of the market economy after the demise of the communist regime. The pre-eminence of private ownership and freedom of contract was reinstated, although their application in practice conflicted with the inertia of the previous legislation.

A new wave of legal transplants accompanied the transition. Relatively poorly articulated legislation, supposedly aimed at aligning Romanian law to modern standards of consumer protection, property law, real estate pub-

* The opinions expressed in this paper are personal and do not represent the views of the Court of Justice of the European Union.

licity, company law, capital markets or secured transactions entwined with the overburdening of the judiciary created significant practical problems. A new wave of codifications in the field of Civil, Commercial and Civil procedure law was scheduled to reset the foundations of the Romanian private law system. European and international harmonization efforts had an undeniable influence. There were, however, very few correlations with the codification processes conducted in neighbouring countries, although some shared a similar experience and encountered similar systemic problems. The causes of this situation seem to lie in the language and informational barriers as well as in the absence of a forum designed to accommodate such exchanges.

This article aims *first* to make a brief presentation of the Romanian private law system and to point out the main influences it received and *second* to give an example of the role played by legal transplants in Romanian private law, namely with regards to the civil/commercial law division and the classic question of the formation of contracts. In this respect, I will make two preliminary statements.

On one hand, I believe that a legal transplant does not only provide a legislative solution for the recipient legal system but also a link to a different legal system which allows the judges and scholars of the recipient legal system to follow the judicial and academic interpretation of the legal system of origin. On the other hand, when a legal order is influenced by several legal systems, the judges and scholars of the recipient legal system have to arbitrate between different transplants in order to achieve coherence and certainty.

II. General information

1. Sources of Romanian Private Law

Legislation is the principal source of Romanian private law. This legislation is founded on the Constitution, the Civil Code, the Commercial Code, the Family Code, the Labour Code, and on numerous other laws and regulations. *Case-law* is not a formal source of law. Judicial authorities have no power to issue rules of general application, their role being solely to apply legal norms to individual cases. Additionally, judicial decisions are governed by the principle of relativity, pursuant to which they apply only to the parties involved in the litigation.[1] It is however largely admitted that

[1] Article 124(3) of the Constitution according to which "The judges are independent and shall only obey to the law" is interpreted as denying the power to issue rules of general application to the judicial authority. The same conclusion is drawn from article 4

the decisions of the higher courts, such as the Courts of Appeal or the High Court of Justice, have a certain authority over the lower courts, especially when the case law of the higher courts is constant.

Mechanisms exist within the Romanian legal system to ensure the unity of the case law. Firstly, when the lower courts differ in their interpretation of the same legal issue, the High Court of Justice may be asked to provide guidance in order to ensure the uniform interpretation and application of the law. In such cases, the decisions of the High Court of Justice are binding.[2] Second, the decisions of the Constitutional Court concerning the unconstitutionality of legal provisions in force have direct, mandatory and general effect.[3]

Customary law has a secondary importance as a source of Romanian private law. In some cases, it may be integrated into a legal norm of legislative origin and thus acquire normative force.[4] In other cases, and irrespective of their incorporation by a legislative provision, customs may be used in the interpretation of acts concluded by the parties.[5]

The scholars' *opinions* as well as the *general principles of law* are not formal sources of law although they may have a significant importance in the adjudication of a case.[6]

---

of the Civil Code pursuant to which "it is forbidden for the judge to adopt, through his decisions, general or regulatory provisions, in the cases before him". Cantacuzino, M.B. – "Elementele Dreptului Civil", Ed. All, Bucureşti, 1998, p. 17. Some authors have nevertheless claimed the opposite: Diamant, B. – "Jurisprudența ca izvor de drept în sistemul de drept" in Revista de Drept Comercial no. 6-1998, p. 109, Diamant, B. – "Câteva argumente în sprijinul tezei că jurisprudența constituie izvor de drept" in Dreptul no. 4/2001, p. 107.

[2] Article 329 of the Civil procedure code.

[3] Article 146(1) of the Romanian Constitution.

[4] This is the case for aspects concerning the use of real property. See, for example, articles 529 and 532 of the Civil Code concerning usufruct, articles 600, 607 and 610 of the Civil Code concerning neighborhood. One important application in the field of obligations is the article 970(2) of the Civil code pursuant to which the contracts must be completed taking into consideration all the consequences drawn by the law, the equity or the customs. In addition, according to article 980 of the Civil Code, customs play a role in the interpretation of the contractual provisions. Several other provisions concerning sale (article 1359 of the Civil code) and lease (articles 1436, 1447, 1451 and 1452) also refer to customs. Gh. Beleiu – Drept civil român, Introducere în dreptul civil, Subiectele dreptului civil, Universul Juridic, Bucureşti, 2005, p. 44.

[5] These customs mainly apply in the fields of commercial and maritime law. Hamangiu, C./Rosetti-Bălănescu, I./.Băicoianu, A.I. – "Tratat de Drept Civil Român", All Beck, Bucureşti, 2002, vol. I, p. 12.

[6] Gh. Beleiu – Drept civil român, p. 46.

2. Historical Overview of Legal Transplants

In the middle of the 19th century, following the union of the former provinces of Walachia and Moldavia, Romanian legislation underwent a process of modernisation along the lines of western legal systems.[7] An important moment in this process was the enactment, in 1864, of the Romanian Civil Code (the Code entered into force on 1 January 1865). The Code was largely inspired by the French Civil Code (1804), and, to a lesser extent, by the Italian Civil Code project[8] and by the Belgian mortgage law (1851).[9] It is interesting to note how the drafting process was influenced by the commentaries of the French scholar Marcadé certain provisions of the French Civil Code.[10] Another important step in the modernisation process was the adoption of the Commercial Code, in 1889, which was largely inspired by the Italian Commercial Code of 1882.[11] At the beginning of the 20th century, several laws were enacted especially in the field of commercial law, concerning for example warehouse warrants[12], consignment agreements[13], banking services[14], cheques[15], bills of exchange and promissory notes.[16]

---

[7] Private law codifications existed in the two provinces prior to their unification. Thus, in Moldavia, the Codex Calimachi (named after the prince Scarlat Calimah) was inspired by the Austrian Civil Code of 1811. In Walachia, "Codul Caragea" was adopted in 1817, and relied mainly on Byzantine law. Hamangiu et al. (*supra* note 5), , vol. I, p. 19.

[8] Among others, articles 743 (division), 751, 756, 761, 828 (donations), 942 (definition of the contract), 967 (presumption of cause), 971 (transfer of rights in rem), 1073, 1074, 1080 (effects of obligations), 1005 (liability for torts) have been inspired by the Italian project. For details, see Hamangiu et al. (*supra* note 5), vol. I, p. 22. The Civil Code of the Reign of Italy was enacted in 1865, after the Romanian Civil Code.

[9] Hamangiu et al. (*supra* note 5), vol. I, p. 23.

[10] For instance, the Romanian Civil Code did not incorporate the provision of article 1589 of the French Civil Code, pursuant to which "La promesse de vente vaut vente, lorsqu'il y a consentement réciproque des deux parties sur la chose et sur le prix." This omission, that ultimately led to a different evolution of the Romanian law, as compared to French law, in the matter of pre-agreement for sale, was apparently linked to the comments of Marcadé on the issue. This decision not to follow the French model was nevertheless upheld by Romanian legal literature. Hamangiu et al. (*supra* note 5), vol. II, p. 548.

[11] Published in the Official Monitor of 10 May 1887. Cărpenaru, St.D. – "Drept Comercial Român", ed. VI, Universul Juridic, Bucureşti, 2007, p. 12.

[12] Law no. 153/1937, concerning general stores and the warranting of merchandise and crops, published in the Official Monitor no. 71/1937.

[13] Law no. 178/1934, concerning the regulation of the consignment agreement, published in the Official Monitor no. 173/1934.

[14] Law no. 70/1934 concerning the organization and the regulation of the banking industry, published in the Official Monitor no. 105/1934.

The Civil Code remained in force throughout the communist period (1948–1989), although several special rules were enacted in various fields of private law: family law[17], labour law[18], regarding the status of natural persons and legal entities[19], the statutes of limitation[20], and contracts[21]. Moreover, the Civil Code was integrated into the body of socialist legislation which was supposed to bring its fundamental principles into line with the values of socialist societies.[22] The Commercial Code was not abrogated during the communist regime, although the changes in social and political paradigms made it largely inapplicable.[23] Nonetheless, the Civil Code remained the backbone of the Romanian private law system and, it would appear that, at least in what concerns relationships between individuals falling outside cooperative or economic law, the liberal ideals it enshrined persisted and forged a law favourable to private ordering rather than to mandatory rules.

After the fall of the communist regime in December 1989, as social and political paradigms changed radically, some of the dormant legislation and in particular the Commercial Code was reevaluated. This allowed incipient forms of market economy to reemerge and operate immediately after 1990.[24]

---

[15] Law no. 59/1934 concerning the cheque, published in the Official Monitor no. 100/1934.

[16] Law no. 58/1934 concerning the bill of exchange and the promissory note, published in the Official Monitor no. 100/1934.

[17] Adopted by the Law no. 4/1954, re-published in the Official Bulletin I/1956.

[18] The first Labour Code was adopted by the Law no. 3/1950. It was followed by a second Labour Code adopted by the Law no. 10/1972, published in the Official Bulletin no. 140/1972.

[19] Decree no. 31/1954 concerning natural persons and legal entities, published in the Official Bulletin no. 8/1954.

[20] Decree no. 167/1958 concerning the statutes of limitation, published in the Official Bulletin no. 19/1958.

[21] E.g. Law no. 71/1969 concerning commercial contracts, published in the Official Bulletin no. 60/1979. Pop, A./Beleiu, Gh. – "Drept economic socialist român", Bucureşti, 1983, passim.

[22] Eliescu, M. – "Dialectica formei şi conținutului dreptului în perioada de trecere de la orânduirea capitalistă la cea socialistă şi unele aspecte ale acestei dialectici în etapa de desăvârşire a construirii socialismului" in Studii şi Cercetări Juridice nr. 3/1964, p. 395.

[23] For the application of the Civil and Commercial Codes in international trade matters during the communist period see Căpățână, O./Ştefănescu, B. – "Tratat de Drept al Comerțului Internațional", Editura Academiei Republicii Socialiste România, Bucureşti, 1985, vol. I, p. 36. Cărpenaru (*supra* note 11), p. 12 as well as decisions no. 15/28 April 1972 and 48/22 October 1973 of the Romanian Court for International Commercial Arbitration.

[24] The first legal text which regulated the organization and conduct of business activities under the principle of freedom of commerce was the Decree-law no. 54/1990 adopted

Unfortunately, these regulations proved outdated and the need for reform was rapidly felt. Several laws were enacted in order to remedy these shortcomings, many of them relying on legal transplants to a greater or lesser extent.[25] Thus, fields such as consumer protection, capital markets, competition, and product liability were influenced by EU legislation. Elsewhere, other legal systems were having an impact. One of the clearest examples of this is law no. 99/1999 Title VI concerning the security interest in personal property which was inspired by the UCC Article 9 (USA), and by the personal property securities acts (PPSA) from Canada.[26]

In the absence of accurate legislative coordination and in the context of an accelerating legislative pace, the courts and legal scholars were primarily in charge of ensuring the compatibility of these transplants with each other and with the existing principles of Romanian private law. In this context, the idea of a new Civil Code was conceived, and ratified by a political decision in 1997 leading to the creation of a commission composed of scholars, practitioners and experts from the Ministry of Justice. The commission worked until 2004 and provided the Ministry of Justice with a first draft, which was approved by the Legislative Council and submitted to the Senate. The Senate adopted the proposed draft, which was than transmitted to the Chamber of Deputies. The discussions within the Legal Affairs Commission of the Chamber of Deputies were suspended shortly thereafter.

In 2006, the Ministry of Justice, considering the imminent accession of Romania to the European Union, decided to set up a second commission in order to amend the first draft Civil Code with three main objectives: to extend the ambit of the Code (to include many more types of contracts, international private law and trusts), to integrate the legislation that had been adopted in the meantime and to match with the latest developments in EU law. For example, in the field of obligations, the commission decided not to integrate consumer protection legislation into the Civil Code. There-

---

in February 1990, published in the Official Monitor no. 20/1990. This decree referred to the application of the Commercial Code in the relationship between the participants to the market. Several months later, the Law no. 15/1990 concerning the re-organization of the state enterprises as trading companies provided that the relationship between them were governed by the Commercial Code.

[25] Thus, in the field of commercial law, the Law no. 31/1990 concerning trading companies was adopted in November 1990 and replaced the respective provisions of the Commercial Code. Five years later, Law no. 64/1995 was adopted to govern the judicial re-organization and the bankruptcy displacing as well the respective provisions of the Commercial Code (which had been modified several times and finally replaced by Law no. 85/2006 concerning insolvency, published in the Official Monitor no. 359/2006).

[26] The legislation was prepared following the advice and proposals of the Center for Economical Analysis of Law <www.ceal.org>.

fore, extensive research into EU legislation and CJEU case-law was needed, in particular in the field of pre-contractual, contractual and extra-contractual liability, in order to find flexible solutions which could accommodate existing consumer regulations and allow their future development.

In September 2008, the commission submitted an important set of amendments to the Ministry of Justice. The Romanian Parliament approved the Civil Code project under an accelerated legislative procedure on 22 June 2009.[27] The new Civil Code does not follow a particular model, but tries to offer practical solutions based on a thorough comparative law analysis, among other elements. This demonstrates the breadth of the commission's examination into the legislation of large civil law countries and recent reforms or contemplated reforms (France, Italy, Spain, Germany and the Netherlands) as well as the previous Civil Code projects in Romania.[28] The commission also considered recently adopted civil codes (such as the civil code of Brazil or Quebec) as well as the unification projects being conducted at the European and global level (European Contract Code, UNIDROIT Principles, Principles of European Contract Law, the draft Common Frame of Reference).

III. Example: The Civil – Commercial Law Division and the Formation of Contracts

1. The Civil – Commercial Law Division

Traditionally, at the heart of the Romanian private law system is the division between civil and commercial law.

The lines of this division are found in the Commercial code, which applies an objective criterion pursuant to which the Code's provisions govern all the relationships arising from "acts of commerce" (fapte de comerț) irrespective of the nature of the parties concluding them. Article 3 of the Commercial Code provides a list of activities considered as acts of commerce. Any person concluding on of these acts falls under the rule of commercial law,[29] which may apply to acts of commerce concluded by non

---

[27] According to art. 2664 of the Civil code – Law no. 287/2009 published in the Official Monitor nr. 511 of 24 July 2009, "…(1) The present code enters into force at the date which will be set in the law for its effective application"; For comments on the new regulation and grounds, see *F.A. Baias*, "The Civil Code (Law no. 287/2009)", C.H. Beck Publishing House, Bucharest, 2009.

[28] In particular, the 1941 Civil Code, inspired by the Italian Civil Code Project and by the French-Italian project Code of Obligations, as well as the 1971 Romanian Civil Code project.

[29] Cărpenaru (*supra* note 11), p. 37.

merchants.[30] Legal literature does not consider the enumeration of acts of commerce as exhaustive. Consequently, other activities, such as cinematography, television or tourism have been included in practice in the field of commerce even if they are not mentioned in article 3 of the Commercial Code.[31]

A subjective one supplements this objective criterion. Pursuant to article 4 of the Commercial Code "shall also be acts of commerce any other contracts and obligations of a merchant, provided that they are not civil by nature[32] or that the act itself does not reveal the contrary[33]".

Article 7 of the Commercial Code defines the merchant as any person who performs acts of commerce on a professional basis. According to article 56 of the Commercial Code "if an act is commercial for only one party, all the parties are submitted to the commercial law in what concerns that act, except for the provisions concerning the person of the merchants or unless the law provides otherwise." Therefore, commercial law applies equally to non-merchants when they conclude contracts with merchants although, in the absence of such provision, they should be covered by civil law.[34]

The relationship between the Civil and the Commercial code is governed by the principle of speciality. Therefore, on one hand, according to the first article of the Commercial Code, commercial law shall apply in all matters of commerce, and, when such law does not regulate, the Civil Code shall apply. On the other hand, where conflicting solutions arise, the Commercial Code will prevail in all the instances falling under commercial law.[35]

---

[30] Article 9 of the Commercial Code.

[31] Cărpenaru (*supra* note 11), p. 31.

[32] Such as a will or the adoption of a child and, in theory, the acts concerning real estate.

[33] This exception refers mainly to acts concluded outside the scope of business, provided that they are obviously and objectively outside such scope and the other contracting party is aware of such circumstance. Cărpenaru (*supra* note 11), p. 59. It is important to underline that the commercial law applies not only to the contractual obligations of the merchant, but also to its non contractual obligations, arising, for example, from an undue payment or a benevolent intervention. Cărpenaru (*supra* note 11), p. 58.

[34] Consequently, according to article 945 of the Commercial Code claims deriving from acts which are commercial only for one of the parties shall be limited in time, for all parties, according to the commercial law.

[35] For instance, the Civil code provides the principle that all obligations are by nature divisible among co-debtors. On the contrary, the Commercial Code provides for the joint obligation of co-debtors in commercial obligations (article 42 of the Commercial Code): "(1) In commercial obligations the co-debtors are jointly liable, unless otherwise provided. (2) This presumption shall not apply to non merchants for acts which, in what concerns them, are not acts of commerce".

2. The Formation of Contracts

While the Romanian Civil Code, like its French model, does not regulate the formation of a contract, the Commercial Code follows its Italian model and provides quite extensive regulation.[36] As regards the formation of a contract, it is well known there are, in theory, four possible solutions. A legal order may take into account:

- the moment when the acceptance is issued (the issuance system);
- the moment when the acceptance is sent (the expedition system);
- the moment when the acceptance arrives at the offeror (the reception system) or
- the moment when the offeror takes notice of the acceptance (the information system).

In the absence of a legislative solution, French civil law scholars thoroughly debated the issue of the moment exactly when a distance contract should be considered concluded. The French courts often hesitated to provide a clear answer to this question, considering it a matter of fact and therefore relying mainly on the courts' ability to detect the true "intention of the parties".[37] The Romanian Commercial Code provides for a rather straightforward solution by applying the information system. Not only must the acceptance reach the offeror, but the offeror must have actual knowledge of its content.

According to article 35 of the Commercial Code:

"(1) The synallagmatic contract between distant persons is not perfect if the acceptance does not come to the offeror's knowledge within the time period determined by it or within the time necessary for the exchange of the offer and of the acceptance taking into consideration the nature of the contract.
(2) The offeror can consider good an acceptance that arrived after the expiry of the time it had determined, if it immediately informs the acceptant."

The correlation of these two legal transplants had to be ensured by the Romanian courts and legal scholars. To achieve this, they had three different possible solutions.

First, they could observe the civil/commercial law division reflected by article 1 of the Commercial Code and follow, in purely civil law matters, the French case law and literature.[38]

---

[36] Articles 35 to 39 of the Commercial Code.

[37] Chabas, Fr. – note on the decision of 7 January 1981 of the French Cour de Cassation in Revue Trimestrielle de Droit Civil, 1981, p. 849.

[38] This leads to a separation between, on one side, contracts concluded between merchants or between merchants and non merchants, which are governed by the commercial law and by the "information" system and, on the other side, contracts between non merchants for which the debate of the applicable system remains open.

Second, they could directly or indirectly set aside the rule of speciality and apply to civil law contracts the same solution as the one applied to commercial contracts, following the line proposed by Italian legal literature.

Third, they could develop their own line of thinking, thus come to an original solution.

At the end of the 19th century, Italian scholars favoured the broadening of the scope of articles 36 and 37 of the Italian Commercial Code to civil law contracts.[39] This interpretation led to the solution of the Italian Civil Code of 1942.[40] On the other side, French scholars, in the absence of a provision similar to article 36 of the Italian Civil Code, discussed at length the most appropriate system to be applied to the formation of contracts where the parties' intention could not be determined with sufficient certainty. Some favoured the system of expedition, others the system of reception.[41]

Initially, most Romanian scholars observed closely the civil/commercial law division and consequently "transplanted" from French legal literature the debate on the most appropriate system for the conclusion of contracts by correspondence.

Before the Commercial Code was enacted, the courts, relying on article 1553 of the Civil Code (acceptance of a mandate by performance) applied the issuance system. For instance, in a landmark decision, the Bucharest Court of Appeal stated that:

"when contracts are concluded by correspondence, the contract is formed by acceptance of the offer that is at the time when the letter of acceptance is sent and not when the acceptance is effectively known by the offeror. This interpretation relies on the following principles: 1) that, as the contract is formed by a meeting of minds, this meeting occurs when the acceptance of the offer takes place; 2) there is no legal provision requiring the acceptance to be known by the offeror in order to form a contract, but on the contrary, all the texts (of the Civil Code) suppose that this condition is not necessary (art. 912, 1532 and 1533 of the Civil Code)."[42]

---

[39] According to an Italian commercial law scholar "L'utilité de ce travail (to provide a comprehensive analysis of articles 36 and 37 of the Italian Commercial Code n.n.) pourra excéder le champ du droit commercial, parce que le système accepté par le Code de commerce, en raison de cette force d'analogie qui est inhérente même aux lois commerciales et est une condition indispensable de l'unité de notre droit privé, s'étend également aux rapports juridiques exclusivement civils." C. Vivante – "Traité de Droit Commercial", translated by Jean Escara, M. Giard & E. Brière, Paris, 1912, Tome IV, p. 7.

[40] Article 1326 of the Italian Civil Code.

[41] For details see Aubert, J-L. – "Notions et rôles de l'offre et de l'acceptation dans la formation du contrat", LGDJ, Paris, 1970, p. 346 et seq.

[42] Decision of the Bucharest Court of Appeal of 29 May 1884 in Hamangiu, C. – "Codul Civil Adnotat", All Beck, Bucureşti, 1999, vol. II, p. 391.

After 1887, most courts and legal scholars favoured the "reception" system, pursuant to which the contract is concluded when the offeror receives notice of acceptance. It is not clear whether this reaction was due to the influence of the Commercial Code or rather to the trend existing at that time in French case law and legal literature.[43] I tend to believe that it was the latter. Indeed, Romanian scholars relied on the extensive interpretation given at that time by certain French courts to article 814 of the Civil Code concerning donations.[44]

It is only indirectly that some authors referred to article 35 of the Commercial Code arguing that "in our country (in Romania, as opposed to France) we may also rely on article 35 Commercial Code pursuant to which (…); there is no reason to apply another system in civil law matters."[45] Other scholars considered that the reception system is more rational both for unilateral contracts (such as donation, article 814 of the Civil code, article 932 of the French Civil code) and for bilateral contracts (article 35 of the Commercial Code). Despite there being no bridge between the Civil and Commercial Codes, the latter should serve as a model in civil law matters.[46]

After the Second World War, the influence of French civil law literature faded. Romanian scholars started tracing their own path by bringing solutions for civil contracts in line with the provisions of article 35 of the Commercial Code, while French legal literature and case law continued to rely on the interpretation of the parties' intention,[47] with a certain preference to the expedition system. Indeed, in a landmark decision, the Cour de Cassation stated that "unless otherwise stipulated, a contract does not become perfect when the acceptance reaches the offeror, but when it is issued by the other party"[48]

This evolution did not pass unnoticed. Romanian scholars observed that "in French law, the more recent legal literature based on certain decisions

---

[43] Such as Planiol, Ripert or Demogue cited by Hamangiu et al. (*supra* note 5), C./ Rosetti-Bălănescu, I./Băicoianu, A.I.– "Tratat de Drept Civil Român", vol. II, p. 497.

[44] Hamangiu et al. (*supra* note 5), vol. II, p. 496. According to article 814 of the Civil Code: "(1) The donation does not bind the donor and shall not produce any effects before the day when it is accepted.

(2) The acceptance can be made either in the title itself, or by a separate subsequent authenticated document, before the death of the donor; in latter case, the donation shall produce effects only from the time when the act of acceptance is communicated to the beneficiary".

[45] Hamangiu et al. (*supra* note 5), vol. II, p. 497.

[46] Cantacuzino (*supra* note 1), p. 398.

[47] Malaurie, Ph./Aynès, L./Stoffel-Munck, Ph. – "Les obligations", 3e edition, Defrénois, Paris, 2007, p. 251.

[48] Decision of 7 January 1981 of the French Cour de Cassation, chambre commerciale in Revue Trimestrielle de Droit Civil, 1981, p. 849, note by Fr. Chabas.

of the Cour de Cassation, favours the issuance theory…"[49] Nevertheless, they prefer the reception theory giving a more important role to article 35 of the Commercial Code and underlining the need for a uniform solution. Thus, on one hand, article 35 of the Commercial Code has been supplemented with a rebuttable presumption that the offeror has knowledge of the acceptance from the moment it reaches him. The offeror must then prove that he could not acknowledge its content.[50] On the other hand, leading authors submit that the "reception" system is more rational. The only shortcoming is that the contract is deemed concluded although the offeror has no actual knowledge of the acceptance. This objection is set aside as theoretical, since, in most cases, the offeror acquires knowledge of the acceptance when it receives it.

With regard to the information system, it has also been pointed out "in our legislation, this system is relying on the provisions of article 35 Commercial Code (...). The information system, in its complete form is open to debate. Thus, if we link the conclusion of the contract to the actual information of the offeror on the content of the acceptance, we give room to the capriciousness of the offeror, who, in order to avoid the conclusion of the contract, may refuse to access mail. This is supplemented by the uncertainty related to the exact time when the offeror actually receives the acceptance. Therefore, in practice, it is rightfully considered that reception by the offeror of the acceptance creates a rebuttable presumption that the offeror has been informed of the acceptance. Thus the information system assimilates the reception system, the later being preferable for a future legislation.[51] Today, influential authors state clearly that "in the absence of a regulation in the Civil Code, these legal provisions (article 35 of the Commercial Code) apply also to civil law relationships."[52]

The *new Civil Code* removes the distinction between civil and commercial law. It covers all matters currently governed by the Civil and Commercial Codes as well as an important part of the special legislation.[53] There were several reasons for this provision. There was a need to prevent commercial law applying to non-merchants, and also to clarify the civil/

---

[49] Cosmovici, P.M. – "Drept civil. Drepturi reale. Obligații. Legislație", Ed. All, Bucureşti, 1996, p. 131.

[50] Dogaru, I. – "Contractul. Considerații teoretice şi practice", Scrisul Românesc, Craiova, 1983, p. 137.

[51] Stătescu, C./Bîrsan, C. – "Tratat de Drept Civil", Editura Academiei Republicii Socaliste România, Bucureşti, 1981, p. 67.

[52] Cărpenaru, (*supra* note 11), p. 408 *ad notam*. Turcu, I./Pop, L. – "Contractele Comerciale. Formare şi Executare", Ed. Lumina Lex, Bucureşti, vol. I, p. 112.

[53] Article 1 of the Code gives a very wide scope to the regulation: "The provisions of this code shall govern the patrimonial and extra patrimonial relationships between persons, as subjects of civil law".

commercial law divide, which had proven difficult to grasp conceptually and had created serious practical problems. For instance, determining whether civil or commercial courts have jurisdiction, depends on the civil or commercial nature of the matter.[54] Conflicts of jurisdiction arising from this lack of clarity have caused significant delays in the settlement of disputes, especially in the field of real estate transactions, traditionally excluded from the field of commercial law.[55]

It is important to emphasise the fact that the Code offers a unitary conception of obligation[56] and contract[57]. This means that the application of special rules, in addition to general ones, to relationships involving professionals does not amount to a theoretical divide between the realms of commercial and civil law. The reception system for the formation of contracts has been retained in the new Civil Code as proposed by the legal literature. This has however been made quite strict, in accordance with the solution proposed by Romanian case law and legal literature. This system places a particular emphasis on the importance of communication. In this sense, the contract is considered concluded according to article 1186 when acceptance arrives at the offeror:

"Article 1186 – (1) The contract is concluded at the time and place where the acceptance reaches the offeror, even when the latter does not have knowledge of this for reasons which are not imputable to him.
(2) Likewise, the contract is considered concluded at the time when the recipient of the offer performs a relevant act or a conclusive fact, without informing the offeror, if, pursuant to the offer, to the practices established by the parties, the customs or the nature of the business, the acceptance can be thus made."

---

[54] Article 2 of the Civil procedure code. For further details concerning this issue, see Cărpenaru (*supra* note 11), p. 16.

[55] Cărpenaru (*supra* note 11), p. 39. Maravela, G.T./Stanciu, I. – "Posibilitatea instanței de judecată de a pronunța rezilierea unui contract de închiriere a unui spațiu comercial" in Revista de Drept Comercial no. 7−8/1996, p. 136, Gârbaci, F. – "Caracterul civil al contractului de locațiune imobiliară încheiat între comercianți" in Dreptul no. 8/1997, p. 34. Deleanu, I. – "Natura juridică a contractului de locațiune încheiat între două societăți comerciale, precum şi a acțiunilor care derivă dintr-un asemenea contract" in Dreptul no. 7/1994. Papu, G. – "Despre excluderea imobilelor din domeniul dreptului comercial" in Revista de Drept Comercial no. 2-1998, p. 69, Piperea, G. – "Natura juridică a operațiunilor imobiliare" in Revista de Drept Comercial no. 10/2000, p. 90.

[56] Article 1164 of the Code provides: "The obligation is a legal relation based on which the debtor is bound to provide a performance to the creditor and the latter has the right to obtain what he is owed".

[57] Article 1166 of the Code defines the contract as "… the agreement between two or more parties concluded with the intent to create, modify, transmit or terminate a legal relationship".

IV. Conclusion

This brief presentation was intended to offer a general description of the Romanian private law system and to provide an example as to how the courts and legal scholars of a recipient legal order have to correlate and arbitrate between transplants from several other legal systems.

This example demonstrates that the Romanian private law system is a mixture of legal transplants and original solutions. The originality of these solutions was at times derived from the need to accommodate the influences received from different legal systems in a coherent manner.

The new codifications embody these developments and reset the foundations of Romanian private law, under the undeniable influence of harmonisation efforts at the European and global level. It is nevertheless to be expected that homogeneity will only be achieved in time as the memories of the past gradually disappear.

Private Law Developments in Slovenia – a European Perspective

VERICA TRSTENJAK*

I. Introduction

The idea of creating a modern *ius commune europaeum* modelled on Roman-canonical *ius commune* is not new.[1] The countries of Europe

* This article draws on a presentation on "Privatrechtsentwicklung in Zentral- und Osteuropa" ("Private Law Developments in Central and Eastern Europe") made by the author at a symposium at the University of Vienna on 11 and 12 October 2007: see Trstenjak, V., Slowenisches Zivilrecht: Vom ABGB auf dem Weg zum europäischen Zivilgesetzbuch?, in: Welser, R. (ed.): Privatrechtsentwicklung in Zentral- und Osteuropa, Manz, Vienna 2008, p. 101. The opinions expressed in this paper are personal and do not represent the views of the ECJ; translation into English by Dr. Maja Brkan, référendaire in the Cabinet of Advocate-General Trstenjak.

[1] Zimmermann, R.: Das römisch-kanonische ius commune als Grundlage europäischer Rechtseinheit, Juristenzeitung, 1992, p. 8; Zimmermann, R.: Die "Principles of European Contract Law", Teil I, Zeitschrift für Europäisches Privatrecht, 1995, p. 731; von Bar, C.: Working Together toward a Common Frame of Reference, Juridica International, 2005, p. 17; Trstenjak, V.: Evropski civilni zakonik – možnost, nujnost, utopija?, Pravnik, 2001, p. 677 ff.

demonstrate different stages of harmonization in the field of private law. Slovenia's historical particularities, which encompass the initial incorporation of its territory in other states and eventually its independence, mean that Slovenian law has evolved in a more or less intensive interaction with and dependency on the legal orders of other countries.

For centuries Slovenia was *part of the Habsburg monarchy*. This relationship influenced the position of Slovenia in its historical development, but also in its cultural, social, economic and legal involvement in central Europe. In 1918, Slovenia and several other south Slavic nations were united into the *Kingdom of Serbs*, *Croats and Slovenes*, which became the *Kingdom of Yugoslavia* in 1929. After World War II, Slovenia became part of the new socialist *Federal Republic of Yugoslavia*, where it remained until 1991. During those years, it experienced relatively intense national conflicts within the Federal Republic of Yugoslavia. Laws pervaded by particular socialist dogmas were in force that affected private property, contract law, company law and many other areas. After 1945, civil law was not systematically or uniformly regulated in the territory of Yugoslavia; some areas of civil law were governed by federal laws, while others remained within the jurisdiction of the former republics, including Slovenia.

After gaining *independence in 1991*, Slovenia adopted new legislation in almost all areas, including its constitution,[2] which established the foundations of the new system. This change was significant because it founded a new legal system that differed from the former socialist system. These changes brought challenges and advantages at the same time. In the process of preparing the new legislation, the laws of many countries and the laws of the EU/EC[3] were analyzed, with the result that many Slovenian laws today are to be regarded as modern legislation, as modern solutions were adopted from other countries. In creating a new legal system, Slovenia relied heavily on the German and Austrian legal systems, mainly due to its historic ties to these systems. In 1991, because it was impossible to amend the entire legal system overnight, Slovenia decided to use the old Yugoslav laws until it could review and adopt new laws,[4] following the

---

[2] The Constitution of the Republic of Slovenia was adopted on 23 December 1991. Official Journal of the Republic of Slovenia (hereafter: OJ RS), no. 33/91, 28.12.1991, p. 1373.

[3] The abbreviation EU is used hereafter to refer to the EC as well as the EU legal order.

[4] See Article 4 of the Constitutional Act Implementing the Basic Constitutional Charter on the Independence and Sovereignty of the Republic of Slovenia (OJ RS, no. 1/91-I), which contains, in addition to the provision on continuity of legal regulation, the provision that federal powers of the former Yugoslavia were passed on to the bodies of the Republic of Slovenia.

principle of continuity after independence. The principle of continuity was also observed in the field of civil law.

Soon after independence, Slovenia began negotiations for EU membership, a challenging and difficult task, but also one that facilitated the founding of a more modern legal system. Even prior to *2004, when Slovenia became a member of the EU*, all legislation in the field of private law was adopted in accordance with EU regulations and directives.[5]

II. The Development of Civil Law in Slovenia: From ABGB to the New Slovenian Legislation

1. From ABGB to Slovenian legislation in the new Republic of Slovenia

In the territory of Slovenia, regardless of the country of which it was part, the Austrian *Allgemeines Bürgerliches Gesetzbuch* (General Civil Code, hereinafter: ABGB) was always an important source of law. The ABGB had been in force since 1812 and remained in force throughout the period when Slovenia was part of the Habsburg Monarchy.

After World War II, when Slovenia became part of the former Yugoslavia, the ABGB began to be gradually repealed. Civil law initially fell predominantly within the jurisdiction of the Federal Republic of Yugoslavia, while family and inheritance law remained within the jurisdiction of Slovenia. In areas that were not regulated anew by the Federation, the ABGB could still be used in specific legal forms,[6] meaning the ABGB still

---

[5] Although it signed the association agreement as the last of the ten new members, on 10 June 1996, Slovenia was one of the most successful countries in terms of the speed and effectiveness of the negotiations for accession to the EU. See Europe Agreement establishing an association between the European Communities and their Member States, acting within the framework of the European Union and the Republic of Slovenia, (OJ EU L51, 26.2.1999, p. 3) and Information concerning the entry into force of the Europe Association Agreement with Slovenia (OJ EU L 51, 26.2.1999, p. 212).

[6] Old laws could be used as the so-called "Rechtsregeln". In practice, "Rechtsregeln" meant that the law could be used if it did not contradict the new legal regulation and if a particular field was not covered by the new law. This practice was regulated by the Act on derogation of legal rules issued before 6 April 1941 and during the enemy occupation; Official Journal of the Federal People's Republic of Yugoslavia (hereafter: OJ FPRY), no. 86/1946, p. 1078. The Act came into force in 1946, and Article 3(1) provided that rules contained in the laws and legal regulations that were in force on 6 April 1941 could be applied. Article 4 stipulated that these legal rules were not mandatory but that they could be used for relationships that were not governed by regulations in force, but only as long as they were not in conflict with the Constitution of the Federal People's Republic of Yugoslavia, constitutions of other republics, laws and applicable regulations, nor with the principles of constitutional order of Federal People's Republic of Yugoslavia. This

served as a legal source in many areas. However, some areas of the former socialist federal law, such as private property, were regulated in a completely different way.[7] In addition, in the Federation there were no companies comparable to those that existed in other developed European countries, meaning that the notion of a legal person was not developed.[8]

In 1978, the Obligations Act came into force in Yugoslavia regulating the law of obligations in a new, modern way.[9] Thus, the law of obligations from the ABGB was applied on a limited basis, for example, to individual contracts. In 1980 the Basic Property Law Relations Act[10] came into force in Yugoslavia and specifically regulated a part of the substantive law. Although this development was similar to, or the same as in other parts of the former Yugoslavia, Slovenia had its own legislation for the family law, namely the Marriage and Family Relations Act and the Inheritance Act, both of which came into force in 1977. Until 1991, the ABGB was only used if an area was not legally regulated and if the ABGB was not in conflict with the legal (and political) systems of the time. For example, the ABGB was still used for certain contracts, such as donation contracts.

2. Development of Slovenian Civil Law after Independence in 1991

After 1991, Slovenia needed new regulations for the area of civil law. Following independence in 1991, the old federal (Yugoslav) laws could be applied if they were not contrary to the new legal regulation.[11] Incompatible laws often contained specific socialist features, such as restrictions with respect to private property,[12] especially restrictions regarding land,[13]

---

article also stated that state authorities could not rely directly on these legal rules in their decisions.

[7] Private property did not exist, although "personal property" did. A strict land maximum was in force, as were overall restrictions regarding property.

[8] In the former legal system, there were special legal persons based on the Act on Associated Labour. These special legal persons were organizations of associated labour with special features adapted to the socialist system. Cf. Act on Associated Labour, Official Journal of the Socialist Federal Republic of Yugoslavia (hereinafter: OJ SFRY) no. 53/1976.

[9] OJ SFRY, no. 29/1978.

[10] OJ SFRY, no. 6/1980.

[11] Slovenia regulated the principle of continuity in Article 4 of the Constitutional Act Implementing the Basic Constitutional Charter on the Independence and Sovereignty of the Republic of Slovenia (OJ RS, no. 1/91-I).

[12] The former federal Basic Property Law Relations Act, for example, still contained a (socialist) restriction on private property. Article 10 of this act provided that a citizen could hold a property right on agricultural and other land, forests and forest land, commercial buildings and business premises and means of production intended for personal work in order to obtain income within the limits set by the law.

and provisions requiring contracts to be in accordance with socialist morality.[14] However, some former federal laws in the field of civil law, such as the Obligations Act and the Basic Property Law Relations Act, were still in use.[15] The other two acts within the field of civil law, the Inheritance Act[16] and Marriage and Family Relations Act,[17] were already Slovenian law.[18]

The ABGB could also still be used in some legal fields such as for donation contracts, which has become more common in practice; for commodatum; and particularly for the *societas*. The latter gained importance with the establishment of companies that were regulated by a modern Companies Act in 1993.[19] However, the *societas* in Slovenia was not legally regulated until the enactment of a new Code of Obligations in 2002.[20]

In 2002, Slovenia adopted a new act to regulate real property law[21] which entered into force in 2003. This act deviated from the Austrian model, coming closer to the German Civil Code (*Bürgerliches Gesetzbuch*, BGB). Inheritance and family law, already governed by the old Slovenian acts of 1977, have been amended several times since independence, but these fields are still not regulated comprehensively.

---

[13] The former socialist Slovenian Agricultural Land Act, as a *lex specialis*, laid down the land maximums. Farmers could own not more than 10ha per farm, in accordance with Article 53 of this Act (consolidated version of 1986, Official Journal of the Socialist Republic of Slovenia (hereafter: OJ SRS), no. 17/86), and not more than 20 ha in the mountain regions. Individuals who were not farmers could own not more than 1 ha in flat regions, pursuant to Article 60 of this Act, and not more than 3 ha in the mountains. Articles 53 to 60 of the consolidated text of this Act on land maximum (OJ SRS, no. 17/86) were annulled by the Constitutional Court in its decision U-I-122/91 (OJ RS, no. 46/92).

[14] See Article 10 of the Obligations Act, which stated that participants in trade freely determine obligations, which should not be in conflict with the constitutional principles of social regulation, mandatory provisions or morality of a self-managed socialist society.

[15] OJ SFRY, no. 6/1980; the last change in the Basic Property Law Relations Act was made in 2002 (OJ RS, no. 87/2002). Since the end of the 2002 the Basic Property Law Relations Act was no longer in force because of the new Slovenian Law of Property Code.

[16] OJ SFRY, no. 15/1976.

[17] OJ SFRY, no. 15/1976.

[18] Regulation of inheritance and family relationships was in the purview of the Yugoslav republics.

[19] OJ SFRY, no. 30/93. Article 3(2) of the Companies Act stipulated that, until the company acquires legal personality (in Slovenia, with the entry into the court register), the relationships between partners were governed by the rules of *societas* under civil law, which was, in practice, a reference to ABGB.

[20] Code of Obligations (OJ RS, no. 83/2001).

[21] Law of Property Code (OJ RS, no. 87/2002).

III. Legal Regulation of Civil Law *de lege lata*

1. System and sources of civil law in Slovenia

In the creation of its own legal system after independence, despite several differing theoretical views,[22] Slovenia did not opt for a new civil code. Therefore, the field of civil law is regulated by several acts or codes that govern classic civil law areas that, in other countries, are regulated by civil codes. Currently, the main civil law acts are:

- The Code of Obligations (2002)[23] *(Obligacijski zakonik)*
- The Law of Property Code (2003)[24] *(Stvarnopravni zakonik)*
- The Inheritance Act (1977)[25] *(Zakon o dedovanju)*
- The Marriage and Family Relations Act (1977)[26] *(Zakon o zakonski zvezi in družinskih razmerjih)*

Certainly, numerous other acts regulate the field of civil law. It is particularly important to note that the present system does not contain a comprehensive civil code containing a general section on civil law; general provisions are included in numerous acts in a range of areas, from family law to company law.[27] Two acts adopted in 1995 in the field of legal persons were the Societies Act *(Zakon o društvih)* and the Foundations Act *(Zakon o ustanovah)*.[28] The new Societies Act of 2006[29] regulated societies for the first time after the Second World War; these laws did not exist in

---

[22] Cf. Trstenjak, V.: Koliko zakonikov na področju civilnega prava v Sloveniji?, Pravna Praksa, no. 26–27/2001, p. 5–6; Trstenjak, V.: Das neue slowenische Obligationenrecht, WGO, Monatshefte für osteuropäisches Recht, 2002, Vol. 44, no. 2, p. 90–110.

[23] OJ RS, no. 83/2001; the law came into force on 1 January 2002.

[24] OJ RS, no. 87/2002.

[25] OJ SRS, no. 15/1976, 23/1978, OJ RS, no. 17/1991-I-ZUDE, 13/1994-ZN, 40/1994; decision of the Constitutional Court U-I-3/93-17, 82/1994-ZN-B, 117/2000, and decision of the Constitutional Court U-I-330/97-28, 67/2001, 83/2001.

[26] Consolidated version, OJ RS, no. 69/2004.

[27] The provisions on contractual capacity are also contained in family law. For example, Article 29(2) of the Marriage and Family Relations Act provides that a wedding witness can be any person having contractual capacity. Article 115 states that, if one parent is deprived of parental capacity, the other parent has all parental rights. The second paragraph of Article 117 provides that a minor acquires full contractual capacity with marriage, while the third paragraph of this article stipulates that full contractual capacity can also be obtained by a minor who has become a parent, if important reasons for granting contractual capacity exist.

[28] Both acts in OJ RS, no. 60/95.

[29] OJ RS, no. 61/2006, p. 6605.

the time of socialism due to restrictions on private property.[30] Societies were regulated by a special act before independence, but while the act did not refer to societies in the modern sense, the Societies Act of today has been modernised and adapted to European standards.[31] Civil procedure law is regulated by the Civil Procedure Act (1999),[32] while non-litigious procedure is regulated by the Non-Litigious Civil Procedure Act.[33]

The Slovenian law of obligations did not undergo significant changes as the old Obligations Act from 1978 was modern for its time. The new Code of Obligations is extensive, with 1062 articles. While the legislature wanted to fully regulate the law of obligations, and thus chose to call it a Code,[34] there are numerous acts besides the Code that regulate specific obligations. The majority of provisions were taken from other acts; contracts and institutes, which had not previously been regulated, were added, including donation contracts,[35] *societas*[36], *commodatum*, and some types of damages (e.g., liability for damage caused by animals). The Code contains

---

[30] More specifically in Trstenjak, V.: Stiftungen im slowenischen Recht, Recht in Ost und West, 1997, Vol. 41, no. 9, p. 305–331; Trstenjak, V.: Das slowenische Rechtssystem und die Entwicklung und Stellung der Stiftungen, in: Zur Privatrechtsentwicklung der ehemals Sozialistischen Staaten Mittel- und Südosteuropas/Hrsg. vom Institut für Rechtsvergleichung, Universität Wien durch Hans Hoyer – Wien, Graz: NWV, 2003. For the development of societies, see also Trstenjak, V.: Pravne osebe, Gospodarski vestnik, Ljubljana, 2003, p. 343ff.

[31] More specifically, concerning societies in Slovenia, cf. Trstenjak, V.: Die neue rechtliche Regelung der Vereine in Slowenien, WGO, 1997, no. 4, pp. 265–282.

[32] Consolidated version, OJ RS, no. 73/2007.

[33] OJ RS, no. 30/1986 (20/1988 – corr.), OJ RS, no. 87/2002-SPZ, 131/2003.

[34] Implementation of the new Code of Obligations initially caused unequal treatment between obligations established before the entry into force of this Code and those created afterward, with respect to the principle of *ne ultra alterum tantum.* This Code introduced this principle into Slovenian law, whereby obligations arising prior to its entry into force were governed by the provisions of Obligations Act. See, in this regard, Article 1060 of the Code of Obligations. The Slovenian Constitutional Court decided that this regulation infringed on the Slovenian constitution. According to the Constitutional Court, this provision was contrary to Article 14 of the Constitution (equality before the law). See decision U-I-300/04-25 of 2 March 2006, OJ RS, no. 28/2006.

[35] Regarding certain aspects, donation contracts are regulated differently than in the Austrian ABGB. For example, paragraph 944 of the ABGB allows donation of all presently owned property and no more than half of future property, while the Code of Obligations does not specify the scope of donated property; the Code of Obligations (Article 540) allows a donation to be revoked as a result of ingratitude and so differs from paragraph 948 of ABGB, which considers conduct of a donatory that may be criminally prosecuted as "great ingratitude". With respect to paragraph 948 of ABGB, cf. Trstenjak, V.: Novost v slovenski zakonodaji, Pravna Praksa no. 5/2002, p. 13.

[36] Zabel emphasized that the scope of the regulation of the *societas* is wider than that in ABGB. Zabel, B.: in Juhart, M., Plavšak, N. (ed.): Obligacijski zakonik s komentarjem (posebni del), Book 4, Ljubljana, 2004, p. 927.

a comprehensive general section, where fundamental principles are explained, and includes general provisions on the conclusion of contracts, liabilities for damages, and both general and specific liabilities (e.g., liability for damage caused by hazardous objects, the responsibility of organizers of events, the responsibility of owners of animals, the responsibility of owners of buildings). The Code extensively regulates both material and non-material damage[37] and covers also quasi-contracts (unjustified enrichment and *negotiorum gestio*). The second part of the Code deals with all classical types of contracts but, in spite of its modern formulation, the Code of Obligations does not regulate the most recent types of contracts, such as franchising and factoring. What is more, the Code of Obligations does not incorporate existing European consumer protection directives in their entirety.[38] Instead, these directives have been gradually transposed into special acts, such as the Consumer Protection Act. In fact, many of the acts adopted after 1991 are linked to the field of law of obligations, such as those governing securities, copyright and industrial and intellectual property, and consumer protection, as well as the Notary Act.[39]

Inheritance and family law have been amended several times recently in response to societal developments. The Marriage and Family Relations Act allowed the institute of extra-marital union, which is equivalent to marriage, even before 1991. The law also regulates the relationship between parents and children, such as parental rights and the right to maintenance, adoption, foster care, and guardianship. Some special acts are also in force in the area of family law, such as the Infertility Treatment and Procedures of Biomedically-Assisted Procreation Act[40] and the Foster Care Act.[41] In 2005 the Registration of a Same-Sex Civil Partnership Act came into force.[42] The Inheritance Act of 1977 regulates both statutory as well as testamentary succession; in recent years, this act has not undergone major changes, so it still shows the weaknesses of a socialist legal order.

The Law of Real Property is regulated by a new, comprehensive Law of Property Code, which has 276 articles covering all the classical institutes

---

[37] Article 179(1) of the Code of Obligations provides that "for suffered physical pain, mental pain as the result of reduced life activity, deformation, insult of good name and honour or limitation of freedom or personal rights or the death of a relative, and fear, the victim, if justified with the circumstances of the case and particularly with the degree of pain and fear and their duration, has a right to a fair monetary compensation independent of the reimbursement of material damage, even if there is no material damage".

[38] Similarly, Možina, D.: Evropeizacija in modernizacija obligacijskega prava, Podjetje in delo, no. 6–7/2008, p. 1276.

[39] Consolidated version, OJ RS, no. 2/2007.

[40] OJ RS, no. 70/2000.

[41] OJ RS, no. 110-5388/2002.

[42] OJ RS, no. 65/2005.

of real property law. Article 2 enumerates real property rights: ownership rights, security rights, land charge *(Grundschuld),* servitudes, rights of real burden (*Reallast*) and rights of superficies *(Erbbaurecht)*.[43] The right of superficies had not been regulated previously, and land charges follow the German model.[44] Specific areas of substantive law are regulated by numerous special laws, such as the Act on Forests[45] and the Agricultural Land Act,[46] which regulate questions of ownership on forests and agricultural land. The Maritime Code[47] governs, among other matters, particular features of real property rights on ships, and the Housing Act[48] regulates condominiums; real property rights in the area of air navigation are regulated in a special Obligations and Real Rights in Air Navigation Act.[49]

Adoption of the new Law of Property Code was also important because it introduces a clearer distinction between real property law and the law of obligations. Thus, some areas which were previously covered by other laws – for example, mortgage, which was previously regulated by the Obligations Act,[50] or non-possessory mortgage, which was previously regulated by the Execution of Judgments in Civil Matters and Insurance of Claims Act[51] – are now incorporated in the more comprehensive Law of Property Code. The area of real property law is also covered by a new Land Registry Act which came into force in 2003.[52] Until the adoption of the Slovenian Land Registry Act in 1995, the old act from 1930, a copy of the

---

[43] Unlike Austrian law, the Slovenian Law of Property Code does not regulate the so-called *superedifikat*, which is an exception to the principle of *superficies solo cedit* in paragraph 434 of ABGB.

[44] With respect to land charges, the Slovenian legislature decided to follow the German model rather than the Austrian one. Austrian law does not regulate land charges *(Grundschuld)*. Article 192(1) of the Law of Property Code states that "the land charge is the right to the repayment of a specific amount of money of the property value before other creditors of a lower order". Therefore, land charge refers to the right of a creditor to request repayment of his debt from the property value before other creditors. More on land charges also in Vrenčur, R.: Moderne oblike zavarovanja plačil, Gospodarski vestnik, 2005, p. 277.

[45] OJ RS, no. 30/1993, p. 1677.

[46] OJ RS, no. 59-3454/1996, p. 5132.

[47] Consolidated version, OJ RS, no. 120/2006.

[48] OJ RS, no. 69/2003, p. 10633.

[49] OJ RS, no. 12-559/2000, p. 1549.

[50] Mortgages were regulated in Articles 966–996 of the Obligations Act; however, the new Code of Obligations contains no provisions on mortgages.

[51] For more on the relationship between the Law of Property Code and Code of Obligations, see Tratnik, M.: Stvarnopravni zakonik in obligacijsko pravo, Pravna praksa no. 6/2002, p. 1392.

[52] OJ RS, no. 58-2857/2003, p. 6717.

Austrian law from 1871 that was valid for the whole former Yugoslavia, was in force.[53]

Slovenia also adopted a special Housing Act immediately after independence,[54] which allowed private ownership of apartments and their privatization. Until the act was adopted, the majority of apartments were under the regime of so-called social property. To regulate "normal" property relationships, it was also necessary to adopt acts on privatization[55] and the Denationalization Act,[56] however, the processes concerning these two acts are essentially outdated today.

2. Adaptation of Slovenian civil law to Union law

As part of its preparations for membership in the EU, Slovenia began to change its civil laws in order to align them with those of the EU soon after its independence in 1991.[57] Nevertheless, many provisions of the directives in the field of civil law were transposed to special laws. For example, a number of directives concerning consumer protection were transposed to special acts.[58] Some of their provisions are also contained in the *Code of Obli-*

---

[53] More specifically, Juhart, M. in Juhart/Tratnik/Vrenčur, Stvarno pravo, Gospodarski vestnik, Ljubljana 2007, p. 150.

[54] In 2003 a new Housing Act (OJ RS, no. 69/2003) was adopted.

[55] In the area of privatization, several laws were passed: for example, the Housing Act (OJ of the RS, no. 181991) (Chapter VIII regulated privatization and the privatization of apartments and residential houses); the Ownership Transformation of Companies Act (OJ RS, no. 55/1992); the Act Regulating the Privatisation of Legal Entities Owned by the Development Fund of the Republic of Slovenia and the Obligations of the Agency of the Republic of Slovenia for Restructuring and Privatisation (OJ RS, no. 71/ 1994); the Agency of the Republic of Slovenia for Restructuring and Privatization Act (OJ RS, no. 7/1993); the Privatisation of the Slovene Steelworks Act (OJ RS, no. 13/ 1998); and the Act Concluding Ownership Transformation and Privatisation of Legal Entities Owned by the Development Corporation of Slovenia (OJ RS, no. 30/ 1998).

[56] OJ RS, no. 27I/1991-I.

[57] See also Možina, D.: Harmonisation of Private Law in Europe and the Developments of Private Law in Slovenia, Juridica International, XIV/2008, p. 173–180.

[58] For example, the Consumer Protection against Unfair Commercial Practices Act (OJ RS, no. 53/07, p. 7241) transposes the Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/ EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (Unfair Commercial Practices Directive) (OJ EU L 149, 11.6.2005, p. 22). The Rules on price indication for goods and services (OJ RS, no. 63/1999, p. 8166) transpose Directive 98/6/EC of the European Parliament and of the Council of 16 February 1998 on consumer protection in the indication of the prices of products offered to consumers (OJ EU L 80, 18.3.1998, p. 27).

gations.[59] For example, guarantees for correct functioning of things are regulated in Articles 481 to 487 of the Code of Obligations, and the liability of the organizer of package travel for damage to the consumer resulting from a failure to perform or the improper performance of the package travel contract[60] is regulated by Article 890 of the Code of Obligations.[61]

The *Consumer Protection Act*[62] transposes the directives on contracts negotiated outside of business premises[63], on distance contracts[64], on misleading advertising[65], on time sharing[66], on liability for defective products[67], on the sale of consumer goods and associated guarantees[68], on unfair terms in consumer contracts[69], on distance marketing of consumer financial services[70] as well as directives in other areas.[71]

---

[59] See also Možina, D. in Trstenjak, V. (ed.): Evropsko pravo varstva potrošnikov, Gospodarski vestnik, 2005, p. 86–88.

[60] Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours (OJ EU L 158, 23.6.1990, p. 59).

[61] Article 890 of the Code of Obligations stipulates that the "tour operator is liable for damage caused to a passenger due to non-fulfilment or only partial fulfilment of certain obligations relating to the organization of the trip, laid down in the contract and this Code".

[62] Official consolidated version (OJ RS, no. 98/2004), as amended by the decision of the Constitutional Court U-I-218/04-31 (OJ RS no. 46/2006), and a further amendment (OJ RS no. 126/2007).

[63] Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises (OJ EU L 372, 31.12.1985, p. 31).

[64] Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (OJ EU L 144, 4.6.1997, p. 19).

[65] Council Directive 84/450/EEC of 10 September 1984 relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising (OJ EU L 250, 19.9.1984, p. 17), such as amended by the Directive 97/55/EC of the European Parliament and of the Council of 6 October 1997 so as to include comparative advertising (OJ EU L 290, 23.10.1997, p. 18).

[66] Directive 94/47/EC of the European Parliament and the Council of 26 October 1994 on the protection of purchasers in respect to certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis (OJ EU L 280, 29.10.1994, p. 83).

[67] Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products (OJ EU L 210, 7.8.1985, p. 29).

[68] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (OJ EU L 171, 7.7.1999, p. 12).

[69] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ EU L 95, 21.4.1993, p. 29).

[70] Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and

The *Consumer Credit Act*[72] transposes the Directive on consumer credits[73], which has been amended many times[74] and has been replaced as of 2010 by a new directive[75], whereas the Directive on electronic commerce[76] and the Directive on electronic signatures[77] were transposed with the *Electronic Commerce and Electronic Signature Act.*[78] Certain directives (e.g., those concerning electronic services and electronic communications)[79]

---

amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC (OJ EU L 271, 9.10.2002, p. 16).

[71] For example, the Consumer Protection Act also transposes certain provisions of the Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests (OJ EU L 166, 11.6.1998, p. 51) and of the Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours (OJ EU L 158, 23.6.1990, p. 59). For other directives, see Trstenjak, V., Knez, R., Možina D.: Evropsko pravo varstva potrošnikov, Gospodarski vestnik, 2005.

[72] Official consolidated version (OJ RS, no. 77/2004, p. 9281), as amended (OJ RS, no. 111/2007).

[73] Directive 98/7/EC of the European Parliament and of the Council of 16 February 1998 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (OJ EU L 101, 1.4.1998, p. 17).

[74] The Directive on consumer credits was amended with the Directive 98/7/EC of the European Parliament and of the Council of 16 February 1998 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (OJ EU L 101, 1.4.1998, p. 17) and Council Directive 90/88/EEC of 22 February 1990 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (OJ EU L 61, 10.3.1990, p. 14).

[75] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (OJ EU L 133, 22.5.2008, p. 66).

[76] Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce') (OJ EU L 178, 17.7.2000, p. 1).

[77] Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures (OJ EU L 13, 19.1. 2000, p. 12).

[78] Consolidated version (OJ RS, no. 98/2004), as amended by the Electronic Commerce Market Act (OJ RS, no. 61/2006). See also Knez, in Trstenjak et al. (*supra* note 71), p. 108–109.

[79] See Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) (OJ EU L 108, 24.4.2002, p. 51); Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the

were also transposed in the *Electronic Communications Act*[80] and others in the *Payment Transactions Act*.[81] The Directive on general product safety[82] was transposed with the *General Product Safety Act*[83], whereas the Directive concerning products with misleading appearance[84] has been transposed by the *Rules on products with misleading appearance.*[85] The 'Package Travel Directive'[86], which regulates package travel, was partially transposed with *The Promotion of Tourism Development Act*[87] in order to satisfy the requirements of the directive and case law of the European Court of Justice (hereafter: ECJ), particularly the well-known Rechberger, C-140/97 case[88], in which the Court stated that Austria had not properly transposed this directive.[89] In the Promotion of Tourism Development Act, Slovenia also regulated, among other issues, the insolvency of a tourist agent.

Certain provisions in consumer directives relating to consumer protection have also been transposed into other acts, such as the Private International Law and Procedure Act[90] and the Execution of Judgments in

---

electronic communications sector (Directive on privacy and electronic communications) (OJ EU L 201, 31.7.2002, p. 37).

[80] The official consolidated version (OJ RS, no. 13/2007), as amended by the Digital Broadcasting Act (OJ RS, no. 102/2007). Cf. also Knez, R. in Trstenjak (*supra* note 71), p. 102, 106.

[81] OJ RS, no. 30-1252/2002. Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ EU L 166, 11 June 1998, p. 45); Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers (OJ EU L 43, 14.2.1997, p. 25); Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (OJ EU L 275, 27.10.2000, p. 39).

[82] Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety (OJ EU L 11, 15.1.2002, p. 4).

[83] OJ RS, no. 101/2003.

[84] Council Directive 87/357/EEC of 25 June 1987 on the approximation of the laws of the Member States concerning products which, appearing to be other than they are, endanger the health or safety of consumers (OJ EU L 192, 11.7.1987, p. 49).

[85] OJ RS, no. 5/2000 and OJ RS, no. 101/2003.

[86] Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours (OJ EU L 158, 23.6.1990, p. 59).

[87] OJ RS, no. 2/2004.

[88] Judgment of the ECJ of 15 June 1999, C-140/97, Rechberger.

[89] For an analysis in Austrian doctrine, see Schwarzenegger, P.: Ausgewählte Probleme der Staatshaftung nach Gemeinschaftsrecht, Juristische Blätter, 2001, p. 161–166.

[90] OJ RS, no. 56/1999. This act transposes, for example, Article 12(2) of the Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (OJ 1997 L 144, p. 19).

Civil Matters and Insurance of Claims Act.[91] However, the area of real property law, particularly ownership issues, is not regulated by Union law, at least not comprehensively, as this area remains in the competence of the Member States, as provided by Article 345 of the Treaty on Functioning of the European Union (hereinafter: TFEU, ex Article 295 of the EC Treaty, hereinafter: TEC).[92] Furthermore, in the area of family and inheritance law, there are no extensive Union law regulations other than those concerning the determination of competence or questions relating to civil procedure, such as recognition and enforcement of judgments[93], cooperation in matters relating to maintenance obligations[94], service of judicial and extrajudicial documents[95] and taking of evidence[96], and others.[97]

IV. The Importance of ECJ Case Law for Slovenian Law

1. Analysis of selected cases

A certain degree of uniformity in the EU and a major influence on the law of EU Member States has been brought about by the judgments of the ECJ, which interprets the Treaties and secondary legislation on the basis of Article 19 of the Treaty on the EU (corresponding to ex Article 220 TEC) and Article 267 TFEU (ex Article 234 TEC). This interpretation is binding and uniform in all Member States, and the judgments have, in principle, an

---

[91] Official consolidated version, OJ RS, no. 3/2007. This act transposes, for example, Article 2(1)(c) of the Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests (OJ EU L 166, 11.6.1998, p. 51).

[92] Article 345 TFEU states that this Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.

[93] Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (OJ EU L 12, 16.1.2001, p. 1).

[94] Council Regulation (EC) No 4/2009 of 18 December 2008 on jurisdiction, applicable law, recognition and enforcement of decisions and cooperation in matters relating to maintenance obligations (OJ EU L 7, 10.1.2009, p. 1).

[95] Council regulation (EC) No 1348/2000 of 29 May 2000 on the service in the Member States of judicial and extrajudicial documents in civil or commercial matters (OJ EU L 160, 30.6.2000, p. 37).

[96] Council Regulation (EC) No 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters (OJ EU L 174, 27.6.2001, p. 1).

[97] Cf. Trstenjak,V: Pomen, razlogi in področja poenotenja evrospkega civilnega procesnega prava, Podjetje in delo, no. 6-7/2005, p. 1109–1118; Rijavec, V.: Postopek potrditve Evropskega izvršilnega naslova, Podjetje in delo, no. 5/2007, p. 792–814.

erga omnes effect.[98] There are many important cases in the field of civil law, and particularly in the field of consumer law. Examples include the well known case of *Leitner, C-168/00,*[99] in which the ECJ, on the basis of a preliminary reference of *Landesgericht Linz* (Austria), interpreted the concept of damages as stated in the Directive on package travel.[100] The question related to the concept of damage in Article 5 of this directive; more precisely, the question was raised whether the concept of damage includes non-material damage caused by loss of enjoyment of a holiday. In this case, the ECJ ruled that Article 5 of the directive must be interpreted to include non-material damage resulting from the non-performance or improper performance of the services constituting a package holiday. In Slovenia, non-material damage is extensively regulated; however, the relevant provision of Article 890 of the Code of Obligations must also be interpreted in accordance with the concept of non-material damage, as in the Leitner case.[101] Recently, four Slovenian tourists brought an action against a Slovenian travel agency for non-material damage caused by loss of enjoyment of their holidays in Turkey; in support of their action, they referred to the Leitner case of the ECJ.[102]

In recent case law, the case of *Quelle, C-404/06,*[103] concerned guarantees in the context of the sale of consumer goods. The preliminary reference by the Bundesgerichtshof (Germany) on the basis of Article 267 TFEU (ex Article 234 TEC) concerned the interpretation of Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees (hereafter: Directive 1999/44).[104] The question concerned the right of the seller, where goods not in conformity with the contract are replaced, to require the consumer to pay compensation for the use of those

---

[98] See, for example, Lenaerts, K., Arts, D., Maselis, I., Bray, R.: Procedural Law of the European Union, 2nd ed., London, 2006, p. 195, paragraph 6-031; Van Raepenbusch, S.: Droit institutionnel de l'Union européenne, 4. ed., 2005, Brussels, p. 578 and 642.

[99] Judgment of the ECJ of 12 March 2002, C-168/00, Simone Leitner v TUI Deutschland GmbH & Co. KG.

[100] Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours (OJ 1990 L 158, p. 59).

[101] Cf. Možina (*supra* note 38), p. 1279.

[102] See "Počitnice so se končale v bolnišnici" ("The holidays ended in the hospital"), published in Dnevnik, 27.2.2009.

[103] Reference for a preliminary ruling from the Bundesgerichtshof (Germany) lodged on 28 September 2006 – Quelle AG v Bundesverband der Verbraucherzentralen und Verbraucherverbände (C-404/06) (OJ C 310 of 16.12.2006, p. 5); the opinion of Advocate-General Trstenjak was delivered on 15 November 2007, and the judgment was given on 17 April 2008.

[104] Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (OJ EU L 171, 7.7.1999, p. 12).

goods.[105] The core issue of the question was whether the seller may require compensation from the consumer for use of the goods originally delivered, which were not in conformity with the contract. In Germany, the right to compensation in case of replacement of such goods provoked a wide-ranging academic debate.[106]

As Advocate General in this case, I proposed that the court should decide that Article 3 of the Directive 1999/44 precludes national legislation according to which, if consumer goods are brought into conformity with the contract by their replacement, the seller may require the consumer to pay compensation for use of the goods originally supplied that were not in conformity with the contract.[107] The ECJ decided that Article 3 of the Directive 1999/44 "is to be interpreted as precluding national legislation under which a seller who has sold consumer goods which are not in conformity may require the consumer to pay compensation for the use of those defective goods until their replacement with new goods".

---

[105] The question for a preliminary ruling was worded as follows: "Are the provisions of Article 3(2) of Directive 1999/44, read in conjunction with the first subparagraph of Article 3(3) and Article 3(4) thereof, or of the third subparagraph of Article 3(3) of Directive 1999/44, to be interpreted as precluding national legislation, which provides that, where consumer goods are brought into conformity with the contract by means of delivery of replacement goods, the seller may require compensation from the consumer for use of the goods originally delivered, which were not in conformity with the contract?".

[106] See, for example, Huber, P., Faust, F.: Schuldrechtsmodernisierung. Einführung in das neue Recht, C. H. Beck, München 2002, p. 335, point 55; Westermann, H.P. (ed.), Das Schuldrecht 2002. Systematische Darstellung der Schuldrechtsreform, Richard Boorberg Verlag, Stuttgart, München, Hannover, Berlin, Weimar, Dresden 2002, p. 138 and 139; Westermann, H.P., in Münchener Kommentar zum BGB, 4th ed., C.H. Beck, München, 2004, commentary to Article 439, point 17; Kandler, M.: Kauf und Nacherfüllung, Gieseking, Bielefeld 2004, p. 556; Gsell, B.: Nutzungsentschädigung bei kaufrechtlicher Nacherfüllung?, Neue Juristische Wochenschrift, no. 28/2003, p. 1974; Woitkewitsch, C.: Nutzungsersatzanspruch bei Ersatzlieferung?, Verbraucher und Recht, no. 1/2005, p. 4; Rott, P.: Austausch der fehlerhaften Kaufsache nur bei Herausgabe von Nutzungen?, Betriebs-Berater, no. 46/2004, p. 2479; Hoffmann, J.: Verbrauchsgüterkaufrechtsrichtlinie und Schuldrechtsmodernisierungsgesetz, Zeitschrift für Rechtspolitik, no. 8/2001, p. 349.

[107] In the argumentation, I stressed that Article 3(2) of Directive 1999/44 gives the consumer the right "to have the goods brought into conformity free of charge". Similarly, it can be derived from Article 3(3) of the Directive 1999/44 that the repair or replacement of goods have to be made "free of charge". Thus, a literal interpretation shows that the seller cannot require the consumer to pay compensation for use of the defective goods. A teleological interpretation of Directive 1999/44 leads to the conclusion that its aim is to achieve a high level of consumer protection. See the opinion of Advocate-General Trstenjak in case C-404/06, paragraphs 44 and 51.

The case of *Gysbrechts, C-205/07*,[108] concerned the interpretation of the Union law provisions on free movement of goods in connection with the Directive 97/7/EC on the protection of consumers in respect of distance contracts (hereafter: Directive 97/7).[109] The question for preliminary ruling was referred by a Belgian court *(Hof van Beroep te Gent)* in criminal proceedings against a seller who did not comply with national provisions at issue.[110] In its preliminary reference, the Belgian court asked the ECJ whether Union law provisions on free movement of goods preclude Belgian legislation that prevents a seller from demanding any advance or payment whatsoever from the consumer before the expiry of the withdrawal period of seven working days. Moreover, the national court sought the answer to the question whether Union law precludes national legislation, according to which a seller cannot require a consumer to provide a credit card number during the seven day period for withdrawal.[111] In its judgment of 16 December 2008, the ECJ decided that Article 29 TEC (now: Article 35 TFEU) does not preclude national rules which prohibit a supplier, in cross-border distance sales, from requiring an advance or any payment from a consumer before expiry of the withdrawal period, but Article 29 TEC (now: Article 35 TFEU) does preclude a prohibition under those rules on requesting the number of the consumer's credit card before expiry of that period.[112] Thus, the solution adopted in the judgement was very similar to my opinion as Advocate General,[113] albeit following

---

[108] Reference for a preliminary ruling from the Hof van Beroep, Ghent lodged on 19 April 2007 – Criminal proceedings against Lodewijk Gysbrechts and Santurel Inter BVBA (C-205/07) (OJ C 140 of 23.6.2007, p. 14); the opinion of Advocate-General Trstenjak was delivered on 15 November 2007, and the judgment was given on 17 April 2008.

[109] Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (OJ L 144, 20.5.1997, p. 19).

[110] The question for a preliminary ruling was worded as follows: "Does the Belgian Law of 14 July 1991 on commercial practices and the provision of information to and the protection of consumers constitute a measure having equivalent effect, as prohibited in Articles 28 to 30 TEC, inasmuch as Article 80(3) of that national law prohibits demands for an advance or for payment from the consumer during the compulsory period for withdrawal, as a result of which the actual effect of the Law of 14 July 1991 on the trading of goods in the trader's own country differs from its effect on trading with nationals of another Member State, and does this give rise, in fact, to an obstacle to the free movement of goods, which is protected by Article 23 TEC?".

[111] The facts are summarised in the judgment in the case C-205/07, Gysbrechts, paragraphs 8–15.

[112] Judgment in the case C-205/07, Gysbrechts, paragraph 64.

[113] My opinion was worded as follows: "Article 29 TEC does not preclude a national provision which, in distance selling, prohibits a requirement for an advance or any payment whatsoever by the consumer during the compulsory period for withdrawal if

another approach concerning Articles 28 and 29 TEC (now: Articles 34 and 35 TFEU).[114] The opinion and the judgment equally stressed that a prohibition of advance payment is proportionate to attaining the objective of consumer protection whereas the prohibition on requesting a consumer's credit card number is not proportionate to attaining that objective.[115]

The case of *Messner, C-489/07*,[116] concerned the interpretation of Directive 97/7; the question was referred by a German court *(Amtsgericht Lahr)*.[117] In its preliminary reference, the German court asked the ECJ whether a seller may claim compensation for the value of the use of the consumer goods in case of withdrawal from the contract on the basis of

---

that provision is not interpreted as meaning that, during that period, the vendor may not require the consumer to provide his credit card number, even if he undertakes not to use it to collect payment during that period".

[114] In my opinion, I suggested that the ECJ should change its case law concerning Article 29 EC (now: Article 35 TFEU), in the framework of which the notion of "measures having equivalent effect to quantitative restrictions on exports" within the meaning of Article 29 TEC (now: Article 35 TFEU) was interpreted much more narrowly as the notion of "measures having equivalent effect to quantitative restrictions on imports" within the meaning of Article 28 TEC (now: Article 34 TFEU). In case 15/79, Groenveld, the ECJ held that measures having equivalent effect to quantitative restrictions on exports are "measures which have as their specific object or effect the restriction of patterns of exports and thereby the establishment of a difference in treatment between the domestic trade of a Member State and its export trade in such a way as to provide a particular advantage for national production or for the domestic market of the State in question at the expense of the production or of the trade of other Member States" (paragraph 7). In the Gysbrechts case, I suggested the Court should bring the interpretation of the notion "measures having equivalent effect to quantitative restrictions on exports" within the meaning of Article 29 TEC (now: Article 35 TFEU) closer to the interpretation of the notion "measures having equivalent effect to quantitative restrictions on imports" within the meaning of Article 28 TEC (now: Article 34 TFEU). For a more detailed proposal for change of case law, see the opinion of Advocate-General Trstenjak in case C-205/07, Gysbrechts, paragraphs 53 to 65.

[115] See the opinion of Advocate-General Trstenjak in case C-205/07, Gysbrechts, paragraphs 80–88; judgment in the case C-205/07, Gysbrechts, paragraphs 50–62.

[116] Reference for a preliminary ruling from the Amtsgericht Lahr (Germany) lodged on 6 November 2007 – Pia Messner v Firma Stefan Krüger (C-489/07) (OJ C 22 of 26.1. 2008, p. 25); the opinion of Advocate-General Trstenjak was delivered on 18 February 2009, the judgment has not yet been given.

[117] The question for a preliminary ruling reads as follows: "Is Article 6(2), in conjunction with the second sentence of Article 6(1) of Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts, to be interpreted as precluding a provision of national law which provides that, in the case of a revocation by a consumer within the revocation period, a seller may claim compensation for the value of the use of the consumer goods delivered?".

Directive 97/7.[118] As Advocate General, I opined that the Court should decide that Article 6(1) and (2) of Directive 97/7[119] was to be interpreted as precluding a provision of national law that generally provides that, in the case of a withdrawal by a consumer within the prescribed period, a seller may claim compensation for the value of the use of the consumer goods delivered.[120] Among other arguments, I emphasized that under Article 6(1) of the Directive 97/7 withdrawal from a distance contract within the prescribed period must not be sanctioned by any form of penalty and that the consumer may only be charged the direct cost of returning the goods.[121] Article 6(2) of the Directive 97/7 implies that, in the event of withdrawal, the supplier is obliged to reimburse the sums paid by the consumer free of charge and that the only charge that may be made to the consumer because of the exercise of his right of withdrawal is the direct cost of returning the goods.[122]

The ECJ has later in essence adopted the solution proposed in my opinion by deciding that the provisions of the Directive 97/7 preclude a national provision which provides in general that, in the case of with-

---

[118] The facts of the case are summarised on the basis of the Opinion of Advocate-General Trstenjak in case C-205/07, Gysbrechts, paragraphs 14 to 20.

[119] Article 6(1) and (2) of the Directive 97/7 stipulate:

"1. For any distance contract the consumer shall have a period of at least seven working days in which to withdraw from the contract without penalty and without giving any reason. The only charge that may be made to the consumer because of the exercise of his right of withdrawal is the direct cost of returning the goods.

The period for exercise of this right shall begin:

– in the case of goods, from the day of receipt by the consumer where the obligations laid down in Article 5 have been fulfilled,

– in the case of services, from the day of conclusion of the contract or from the day on which the obligations laid down in Article 5 were fulfilled if they are fulfilled after conclusion of the contract, provided that this period does not exceed the three-month period referred to in the following subparagraph.

If the supplier has failed to fulfil the obligations laid down in Article 5, the period shall be three months. The period shall begin:

– in the case of goods, from the day of receipt by the consumer,

– in the case of services, from the day of conclusion of the contract.

If the information referred to in Article 5 is supplied within this three-month period, the seven working day period referred to in the first subparagraph shall begin as from that moment.

2. Where the right of withdrawal has been exercised by the consumer pursuant to this Article, the supplier shall be obliged to reimburse the sums paid by the consumer free of charge. The only charge that may be made to the consumer because of the exercise of his right of withdrawal is the direct cost of returning the goods. Such reimbursement must be carried out as soon as possible and, in any case, within 30 days".

[120] Opinion of Advocate-General Trstenjak in case C-489/07, Messner, paragraph 111.

[121] *Ibid.,* paragraph 58.

[122] *Ibid.*

drawal by a consumer within the withdrawal period, a seller may claim compensation for the value of the use of the consumer goods acquired under a distance contract. However, similarly as suggested in the argumentation of my opinion[123], the ECJ also decided that the provisions of the Directive 97/7 do not prevent the consumer from being required to pay compensation for the use of the goods in the case where he has made use of those goods in a manner incompatible with the principles of civil law, such as those of good faith or unjust enrichment, on condition that the purpose of that directive and, in particular, the efficiency and effectiveness of the right of withdrawal are not adversely affected, this being a matter for the national court to determine.[124]

2. The importance of the ECJ case law for Member States

All the cases mentioned here demonstrate the importance of the ECJ case law for the Member States. Slovenian judges, other decision-makers and all bodies applying EU law must take these judgements into account. Whether this idea has made its way into the decision-making and the application of EU law in practice is difficult to determine. While certain judgments do not raise any problems in Slovenia, since the provisions are already in conformity with the interpretation of the ECJ (e.g., questions relating to guarantees as in the Quelle-case), it is however noteworthy that Slovenian courts have not yet referred any question for preliminary ruling pursuant to Article 267 TFEU (ex Article 234 EC) in the field of private law. The Slovenian courts have, however, already asked preliminary questions in other fields.[125]

Regarding actions for failure to fulfil obligations pursuant to Article 258 TFEU (ex Article 226 TEC), Slovenia counts among the "obedient" Member States. Until now, only four actions were filed against Slovenia: the first one that concerned the failiure to transpose a Directive relating to railways[126] was withdrawn.[127] In the second case concerning the non-

---

[123] Opinion of Advocate-General Trstenjak in case C-489/07, Messner, paragraph 91.

[124] Judgment of the ECJ of 3 September 2009, C-489/07, Messner, paragraph 29.

[125] See Case C-403/09 PPU, Detiček in the area of freedom, security and justice and C-536/09, Omejc in the field of agriculture.

[126] Directive 2004/50/EC of the European Parliament and of the Council of 29 April 2004 amending Council Directive 96/48/EC on the interoperability of the trans-European high-speed rail system and Directive 2001/16/EC of the European Parliament and of the Council on the interoperability of the trans-European conventional rail system (OJ 2004 L 164, p. 114).

[127] Action brought on 5 June 2007 – Commission of the European Communities v Republic of Slovenia (C-267/07) (OJ C 170 of 21.7.2007, p. 18); order of the President of the ECJ of 14 December 2007 (OJ C 92 of 12.4.2008, p. 25).

transposition of the directive in the field of environmental liability,[128] the ECJ held on 12 March 2009 that Slovenia had failed to transpose the directive.[129] In the third case[130], Slovenia was condemned because of the incorrect transposition of a directive concerning integrated pollution prevention and control[131]. The fourth case[132], which has not yet been decided, concerns the non-fulfillment of the obligations from the directive relating to limit values for certain substances in ambient air[133].

The fact that there has been no action against Slovenia for failure to fulfil its obligations in the field of civil law is due to Slovenia's correct transposition of all the Union legislation in in this area. In civil law and in particular in the context of consumer directives, the Commission has filed quite a large number of actions against "old" Member States (e.g., Spain[134], Greece[135] and Italy[136]) as well as against certain new ones (e.g., Slovakia[137]).

---

[128] Directive 2004/35/EC 1 of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage (OJ 2004 L 143, p. 56).

[129] Action brought on 18 September 2008 – Commission of the European Communities v Republic of Slovenia (Case C-402/08) (OJ C 285 of 8.11.2008, p. 30); judgment of the ECJ of 12 March 2009.

[130] Action brought on 29 January 2010 – European Commission v Republic of Slovenia (Case C-49/10) (OJ C 80 of 27.3.2010, p. 22); judgment of the ECJ of 7 October 2010.

[131] Directive 2008/1/EC of the European Parliament and of the Council of 15 January 2008 concerning integrated pollution prevention and control (OJ L 24, 29.1.2008, p. 8).

[132] Action brought on 16 July 2010 – Commission of the European Communities v Republic of Slovenia (Case C-365/10); ECJ has not yet decided.

[133] Council Directive 1999/30/EC of 22 April 1999 relating to limit values for sulphur dioxide, nitrogen dioxide and oxides of nitrogen, particulate matter and lead in ambient air (OJ L 163, 29.6.1999, p. 41).

[134] For example, judgment of the ECJ of 19 April 2007, C-141/06, Commission/ Spain, concerning non-transposition of Directive 2002/65/EC of the European Parliament and the Council of 23 September 2002 concerning the distance marketing of consumer financial services (OJ EU L 271, 9.10.2002, p. 16); judgment of the ECJ of 9 September 2004, C-70/03, Commission/Spain, concerning an incorrect transposition of the Directive 93/13; judgment of the ECJ of 28 November 2002, C-414/01, Commission/Spain, concerning non-transposition of the Directive 97/7.

[135] For example, judgment of the ECJ of 15 December 2005, C-252/04, Commission/ Greece, concerning non-transposition of the Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) (OJ EU L 108, 24.4.2002, p. 51); judgment of the ECJ of 25 April 2002, C-154/00, Commission/Greece, concerning an incorrect transposition of the Council Directive 85/374/ EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products (OJ 1985 L 210, p. 29); judgment of the ECJ of 14 September 1999, C-401/98, Commission/Greece

V. Conclusion

In the course of its legal history, Slovenia has passed through several stages in the process of harmonizing its laws. Therefore the recent European harmonization has been accepted without deviation. Slovenian civil law is modern and flexible and follows all modern trends. Nowadays, Slovenia is facing an increased adjustment of its civil law to the EU law, necessitated by lively cross-border trade. Many contracts today contain a cross-border element, given the increasing number of contracts concluded on the Internet and given that travelling across borders (which in fact no longer exist) for private or business purposes is an everyday reality. Therefore, in my view, the national laws of the Member States are becoming more and more European while national borders appear increasingly blurred.

Whether or not we can expect a new *ius commune europeaum*[138] at least in the 27 current Member States of the EU with about 500 million citizens depends on several factors. Certain academic proposals, such as the Common Frame of Reference (CFR) and the proposal for a Directive on Consumer Rights[139] which envisage the full harmonization of certain areas of consumer protection law[140] already suggest a development in this direc-

---

concerning non-transposition of the Directive 94/47/EC of the European Parliament and the Council of 26 October 1994 on the protection of purchasers in respect to certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis (OJ 1994 L 280, p. 83).

[136] For example, judgment of the ECJ of 15 January 2009, C-539/07, Commission/ Italy, concerning the non-transposition of the Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) (OJ EU L 108, 24.4.2002, p. 51); judgment of the ECJ of 24 January 2002, C-372/99, Commission/Italy, concerning an incorrect transposition of the Directive 93/13.

[137] For example, judgment of the ECJ of 25 July 2008, C-493/07, Commission/ Slovakia, concerning the incorrect transposition of the Directive 2002/22.

[138] Cf. Zimmermann, Juristenzeitung, 1992 (*supra* note 1), p. 8.

[139] Proposal for a Directive of the European parliament and of the Council on consumer rights (COM(2008) 614 final).

[140] It is foreseen that the Directive on consumer rights will replace the Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises (OJ EU L 372, 31.12.1985, p. 31), Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ EU L 95, 21.4.1993, p. 29), Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (OJ EU L 144, 4.6.1997, p. 19), Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (OJ EU L 171, 7.7.1999, p. 12); see Article 47 of the Proposal for a Directive

tion. I believe that, in view of the successful "Europeanization" of Slovenian law achieved thus far, such harmonization would not be too difficult a task for Slovenia to undertake. Since the country is small (only two million residents) dynamic and young (it has only been 18 years since independence), it is adaptable and, as it has shown, a state fully capable of developing a sound and independent system of civil law.

VI. Annex: Transposition of consumer protection directives into Slovenian law

Directive	**Transposition into Slovenian law**
Council Directive 84/450/EEC of 10 September 1984 relating to the approximation of the laws, regulations and administrative provisions of the Member States concerning misleading advertising (OJ EU L 250, 19.9.1984, p. 17), such as amended by the Directive 97/55/EC of the European Parliament and of the Council of 6 October 1997 so as to include comparative advertising (OJ EU L 290, 23.10.1997, p. 18).	Consumer Protection Act
Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products (OJ EU L 210, 7.8.1985, p. 29)	Consumer Protection Act
Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect ofcontracts negotiated away from business premises (OJ EU L 372, 31.12.1985, p. 31)	Consumer Protection Act
Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (OJ EU L 42, 12.2.1987, p. 48)	Consumer Credit Act
Council Directive 87/357/EEC of 25 June 1987 on the approximation of the laws of the Member States concerning products which, appearing to be other than they are, endanger the health or safety of consumers (OJ EU L 192, 11.7.1987, p. 49)	Rules on products with misleading appearance
Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours (OJ EU L 158, 23.6.1990, p. 59)	The Promotion of Tourism Development Act Consumer Protection Act Code of Obligations

of the European parliament and of the Council on consumer rights (COM(2008) 614 final).

Directive	Transposition into Slovenian law
Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ EU L 95, 21.4.1993, p. 29)	Consumer Protection Act
Directive 94/47/EC of the European Parliament and the Council of 26 October 1994 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis (OJ EU L 280, 29.10.1994, p. 83)	Consumer Protection Act
Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers (OJ EU L 43, 14.2.1997, p. 25)	Payment Transactions Act
Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (OJ EU L 144, 4.6.1997, p. 19)	Consumer Protection Act
Directive 98/6/EC of the European Parliament and of the Council of 16 February 1998 on consumer protection in the indication of the prices of products offered to consumers (OJ EU L 80, 18.3.1998, p. 27)	Rules on price indication for goods and services
Directive 98/7/EC of the European Parliament and of the Council of 16 February 1998 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (OJ EU L 101, 1.4.1998, p. 17)	Consumer Credit Act
Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ EU L 166, 11.6.1998, p. 45)	Payment Transactions Act
Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests (OJ EU L 166, 11.6.1998, p. 51)	Consumer Protection Act
Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (OJ EU L 171, 7.7.1999, p. 12)	Consumer Protection Act
Directive 1999/93/EC of the European Parliament and of the Council of 13 December 1999 on a Community framework for electronic signatures (OJ EU L 13, 19.1.2000, p. 12).	Electronic Commerce and Electronic Signature Act
Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce') (OJ EU L 178, 17.7.2000, p. 1)	Electronic Commerce and Electronic Signature Act
Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (OJ EU L 275, 27.10.2000, p. 39)	Payment Transactions Act

Directive	**Transposition into Slovenian law**
Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety (OJ EU L 11, 15.1.2002, p. 4)	General Product Safety Act
Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) (OJ EU L 108, 24.4.2002, p. 51)	Electronic Communications Act
See Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) (OJ EU L 201, 31.7.2002, p. 37)	Electronic Communications Act
Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC (OJ EU L 271, 9.10.2002, p. 16)	Consumer Protection Act
Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (Unfair Commercial Practices Directive) (OJ EU L 149, 11.6.2005, p. 22)	Consumer Protection against Unfair Commercial Practices Act
Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (OJ EU L 133, 22.5.2008, p. 66)	*[Deadline for transposition: 12 May 2010]*

Private Law in Bulgaria

CHRISTIAN TAKOFF

I. Brief historical review

1. From liberation to communism in Bulgaria

Unlike the German and French history of law, in late 19th century the ideas of the Bulgarian national State did not find their practical effect in the creation of Bulgaria's own (national) civil code.[1]

The reasons for this are due to: 1) the absence of well versed Bulgarian jurists – immediately after the Liberation of Bulgaria (1878) – who were willing and being able to create a new and independent legal system; 2) Bulgaria's inability at that time to rely on a sufficient number of typical customary-law institutes of its own that could give rise to an independent "Bulgarian" legal order; 3) the attractive model of Code Napoléon and other European models which were available and able to be adopted (borrowed) directly.

The logical consequence thereof is that Bulgaria primarily adopted the Roman legal model, adding a number of German admixtures. Thus, contractual, property and inheritance law were adopted from the old Italian Codice Civile (1865);[2] commercial law – from the German Handelsgesetzbuch, bankruptcy – from the relevant Hungarian law,[3] and procedural law – from Russian sources.

The regulation of family law was left to the respective religious institutions and was not regulated by the State.[4]

Bulgaria acceded to the international conventions on intellectual property quite unwillingly; actually, this happened by virtue of military compulsion resulting from signing the 1919 Peace Treaty of Paris-Neuilly.

A particular feature of Bulgarian legal system – not only at the end of the 19th century, but even now – is that Bulgaria has no civil codification. Instead, there have always been numerous acts which correspond to the classical branches of law.

2. During the communist period

This period is characterized by the complete replacement of "the old" law. In the period 1944 – 1950 all civil acts were replaced by new ones, the

---

[1] See Tokushev, D., История на новобългарската държава и право, Сиби, 2001, p. 170 et seq. For the idea of following the genuine Bulgarian usages for the creation of the new legal system, see ibid., p. 168.

[2] See Tokushev (*supra* note 1), p. 175–189.

[3] See Tokushev (*supra* note 1), p. 202–209.

[4] See Tokushev (*supra* note 1), p. 189–202.

regulation of family law came into being, and commercial law was done away with (as being incompatible with the new economic system).[5]

Fortunately, the new regulation is not over-ideologized. On the contrary, inasmuch as the legislation has its ideologies, they are found mainly in the phraseology rather than in the essence of the legal texts. Thus, for instance, the new Act on Obligations and Contracts (1950)[6] adopts a lot of ideas and legislative solutions directly from the new Italian Codice Civile of the year 1942. This Act protects the typical "bourgeois" institutes of bill-of-exchange law[7] and a number of purely commercial contracts.[8] In addition, this act incorporates the matters of limitation periods, attachments on property (pledges and mortgages), as well as the regulation of unilateral statements and direct representation that had not existed until that time. For this reason, the Act on Obligations and Contracts (AOC) provides the important function of a "nucleus" of civil law and is perceived as a "codification act".

However, the AOC did not regulate property, inheritance, personal, family and labour law – they are regulated by way of separate acts and codes.[9] In this period, private international law had no regulation through a separate act of its own. The regulation of private international law was narrowed down to bilateral international treaties.

However, as the idea of centralized planning was dominant at the time, in this period the largest part of the country's economy was governed by way of decrees of the Council of Ministers, and not by civil acts.[10]

II. The time after 1989

Of course, the eradication of ideological remnants and socialist phraseology in civil acts was not sufficient in itself to create an effective private law system. Therefore, along with the "recycled" AOC[11], a number of

---

[5] See the Ordinance on Abolishment of the Commercial Law and of the Law on Limited Liability Companies, Darzhaven Vestnik (D.V.) 78/1951, last amended (l.a.) D.V. 7/1982.

[6] D.V. 275/1950, l.a. D.V. 50/2008.

[7] See art. 370–436.

[8] Like the commission, transportation and insurance contracts (art. 293–356).

[9] Property Act, Inheritance Act, Law on Persons and Family, Family Codes 1968, 1985, Labour Codes 195 and 1987.

[10] See e.g. the numerous Ordinances of the Council of Ministers on the economical mechanism, and on the new economic mechanism from the 70-ies and 80-ies of the last century.

[11] The major contra-ideological amendment was made in D.V. 12/1993, see as well Popov, P./Takoff, Chr., Анализ на измененията на Закона за задълженията и

other acts have been adopted and continue to be adopted, these being acts of absolutely new branches of law:

1. Law of Obligations

Due to the already mentioned lack of codification in the Bulgarian law of obligations (and in particular in the law of contracts) excepting the main legislative act – The Obligations and Contracts Act, which is based on other numerous legislative acts. This includes the Commercial Act (CA) (part III – commercial transactions) as well as other legislative acts too numerous to mention here, concerning transport by automobile, rail, air, river and sea, banking activity, capital markets commerce, conduct of payment services, utilities, waste management, license and transfer of intellectual and industrial property.

Due to the impossibility of presenting all of the matter in a concise volume for this exposition, only the main matters, the general principles of the law of obligations and some special matters will be examined here.

a) General Principles

These general principles are hardly different from the principles typical for most western continental legal systems. Therefore, the exposition shall concentrate more on the exceptions of the general principles or on their particularities which have significant practical application.

aa) Freedom of Contract and Autonomy of Will

The freedom of contract is regulated explicitly (art. 9 from the Obligations and Contracts Act). For the autonomy of will there is no explicit legislative rule, although its acceptance is uncontested.

Exceptions from one or the other principles can be found for example in the imperative rules regulating obligation for entering into agreements (concerning the monopolies), regulating public procurement (in which the public body could not freely chose its contractor) as well as [the archaic] limitations for acquisition of agricultural land for non-EU foreigners.
This principle is limited by the newly revived doctrine of ultra vires, which now exists under a new name and with new regulation.

договорите от ДВ бр. 12/1993 (27 стр.), сп. Търговско право, бр. 2/1993, стр. 16–24 (Analysis of the Amendments of the Law on Obligations and Contracts).

bb) The binding contract

The principle pacta sunt servanda is explicitly regulated in art. 20a of the Obligations and Contracts Act, and has many exceptions to it, which are fairly consistent with the legal framework in other jurisdictions:

- force majeur (art. 306 CA)
- adaption or termination of the contract due to interference in the fundamental transaction of the contract (art. 307 CA)
- the right provided by law or stipulated in a contract for unilateral rescission of the concluded contract (for instance lease, gratuitous lease, commission, commercial representation, employment contract). Furthermore, it should be pointed out that Bulgarian law has no general provision for unilateral termination of long-term contracts;
- rescission of bilateral contracts due to a breach (art. 87 and the following of AOC)
- defence for unperformed contract and right to refuse performance in commercial law (art. 90, art. 315 CA).

cc) Duty of information and transparency

There is no general legislative rule for providing information and ensuring transparency. This rule could be derived by analogy from the obligations for maintaining the bona mores in the contract conclusion (art. 12 AOC) and for performance in good faith (art. 64 AOC).

Despite the lack of a specific act, there are a number of particular provisions which establish these obligations. One large group of such provisions can be found in the consumer law (see 2.9 below). Other, more typical cases, are regulated in the legislation on the capital markets (obligations for drafting of prospectus for securities emissions).[12]

dd) Equality before the law and prohibition of discrimination

This principle is absolutely undisputable, and is further guaranteed by the administrative provisions of the Protection Against Discrimination Act.[13]

In consumer law, however, this principle has a number of exceptions regulated for the benefit of consumers and to the detriment of merchants. Since the blade of justice is pointed to the "bad" for the protection of the "good", these exceptions (unilateral rescission only for the benefit of the consumer, information duties for the detriment of the merchant) are not considered as problematic.

---

[12] See Public Offering of Securites Act, D.V. 114/1999, l.a. D.V. 93/2009.

[13] D.V. 86/2003, l.a. D.V. 103/2009.

ee) Complete remedy for damages

Damage can take the form of economic damage or intangible damage (moral). This applies not only in tort law, for which there is an explicit rule (art. 52 AOC) but also for the law of contracts, where the legislation does not make any difference between material and intangible detriment, but includes a general provision for "damages" (art. 82 AOC).

For decades, scholars have also defended the position of integral compensation for moral damages. However, for decades the courts have refused to grant remedy for intangible damages for a breach of contract. Only in the Tourism Act[14], in the provisions concerning organized trips having a general price for tourists (art. 35, par.5), has the legislature stood firmly behind this position that intangible damages shall be remedied for breach of contract albeit, limited to this type of agreement.

ff) Prohibition for abuse of rights and good faith

The abuse of right is a vague institution in Bulgarian law. It is not clear whether an objective or subjective approach should be applied, it is not clear also what the consequences of this application will be. The subjective theory of misuse, adopted from the German model in art. 289 CA, which requires animus nocendi be proved is strongly criticized by academics for its practical inapplicability.

The general provision concerning misuse (art. 8 AOC) which is based on an objective approach does not require animus nocendi, but is unclear merely stating a prohibition on misuse but not clarifying the consequences where misuse has occurred.

Specific rules can be found in a number of special provisions which counter abuse in a specific way. Those are for instance art. 3 of the Civil Procedure Code (CPC) (liability for damages for abuse of procedural rights), as well as art. 266 AOC (adaptation of a manufacturing contract where the economic situation has changed); and art. 87, par. 4 AOC (prohibition of rescission due to lack of considerable interest).

The general principle of good faith for performance is explicitly provided in art. 63 AOC, and for precontractual relations in art. 12 AOC.

b) Special matters

For conciseness, matters concerning subrogation, assignment of debt, joint and several liability, delay of the performance by the debtor and the creditor, alternative obligations, set-off, novation, release from debt and limitations will not be analyzed here. Due to their volume and their complex-

[14] D.V. 56/2002, l.a. D.V. 82/2009.

ity, all of the matters concerning performance and breach of contract as well as legal remedies could not be analyzed.

aa) Entering into agreement

The contract is concluded in a traditional way via offer and acceptance. The contract is considered concluded with the receipt of acceptance by the person making the offer (art. 14 AOC). Both tacit and explicit conclusion of the contract are recognized.
There are exceptions to this well-known model for contract conclusion for electronic documents (see the Electronic Document and Electronic Signature Act[15]) and where the contract is concluded via the internet (Electronic Commerce Act[16]).

bb) Enforceability

The basic forms of nullity of contracts are void and voidable contracts:

The most important grounds for proclaiming a contract void are: 1) illegality and circumnavigation of the law; 2) immorality; 3) initial impossibility of the consideration; 4) breach of the requirement for a specific form; 5) virtual contract (simulation); 6) complete legal incapacity; 7) severe abuse of will – cases of coercion.

The voidable contract, apart from the classic trinity of error-dolus-metus also applies in the case of partial incapacity, temporary mental capacity (inability to understand or direct one's own actions) and for economic duress (art. 27–33 AOC).

Along with "classical" nullity (void and voidable contracts) Bulgarian law recognizes a number of transitional and derivative forms such as:

- partial nullity (art. 26, par. 4 AOC)
- suspended enforceability
- relative nullity in case of impairment of the creditor through actions of the debtor (art. 133 AOC, art. 646 and 647 CA);
- voidable legal acts of general meetings in the company law (art. 74 and 75 CA);
- nullity of a commercial corporation (art. 70 CA).

There are other forms of nullity in family law and the law of inheritance (of the testament, marriage, acknowledgement of children, adoption), which will not be analyzed here.

---

[15] D.V. 34/2001, l.a. D.V. 38/2007.
[16] D.V. 51/2006, l.a. D.V. 82/2009.

cc) Requirements for forms

Bulgarian law has recognised forms for enforceability (ad solemnitatem) and for evidential purposes (ad probationem) and form stipulated between the parties (art. 293 CA) as well as form for defence against third parties.

The form for enforceability could be according to the means of performance:

- ordinary written form;
- notary certification of the signature;
- notary certification of the date;
- notary certification of the contents;
- notary act.

The practical application of notarised forms, which was limited to real estate and automobile transactions (which are considered as potentially valuable objects), has unfortunately recently spread to an increasing number of cases. This may be explained by an increased level of distrust in society, and consequent need for authentication of statements.

dd) Termination and rescission

A consequence of the principle pacta sunt servanda is that the concluded contract cannot be terminated unilaterally. Exceptions to this principle have already been discussed (see above II.1.a)bb)). To these, we can add a number of hypotheses in which the right of unilateral termination is granted to the consumer for certain types of contracts.

(Voluntary) termination on the grounds of the mutual consent of the parties is always possible (art. 20a, par. 2 AOC).

The termination of bilateral contracts due to a breach of the contract is the most extreme means provided by the law to the creditor. The termination initially can be effected by a statement, and does not have to be in written form unless the contract has been made in writing. If the contract is for transfer of real estate, termination must be carried out before the court to ensure that the claim is recorded in the land registry and thus the rights of the third parties who would like to buy the property are protected.

ee) Proprietary effect of the contract

Bulgaria has adopted the Roman approach to the transfer of property. Property is transferred solely by entering into a contract, without the need for any additional actions or the conclusion of an additional property agreement.

The contract has one more additional proprietary effect. If the property is transferred by a party who is not the owner, one of the prerequisites for

acquiring ownership in this case (along with the good faith and possession) is the conclusion of reciprocal property transfer contract. Such an acquisition could not take effect where the goods are taken from the owner without knowledge or consent, or in the case of the transfer of automobile (art. 78 Property Act (PA)[17]).

The acquisition from a person other than the owner only applies to moveable property. It is inapplicable for real estate or other legal objects different from goods.

2. Labour and social security law

Along with the Labour Code of 1986[18], a number of international conventions and subordinate legislation instruments are currently operative here. An absolutely new branch of law – social security law – has been set up and developed in the past decade.

3. Property Law

Bulgarian property law is relatively stable as it should be for such a legal branch.

The significant legislative acts and basic principles concerning (real estate) property are as follows:

The Constitution of the Republic of Bulgaria regulates the exclusive and the public state and municipal property. It also contains the provisions concerning prohibitions for property acquisition (art. 22).

The most important legislative act in property law is undoubtedly the Property Act. It regulates the prohibition on property acquisition of a land by foreigners (art. 29, 29a) the right of property, joint tenancy, possession, defence of possession and the property and a considerable part of the means for acquiring property.

Subject to a special and restricted status, state and municipal property are regulated in two separate legislative acts – The State Property Act and the Municipal Property Act. Each of these legislative acts has a separate instrument for its application. The main part of the provisions of these two legislative acts is related to the prohibitions and procedures concerning the management and the disposition of the government property (state and municipal), which serves as an indispensible source for preventing corruption in practice. These two acts and their respective instruments for application were indeed introduced to minimize those threats.

---

[17] D.V. 92/1951, l.a. D.V. 6/2009.

[18] D.V. 26/1986, l.a. D.V. 50/2008.

4. Family law

Family law remained stable until the summer of 2009. Although there had been numerous legislative initiatives for the introduction of separate ownership and a contractual regime for property acquired during marriage, and for regulating the cohabitation without marriage, the 1985 Family Code has not undergone any changes in this direction so far.

The only considerable changes concerned child protection and regulation of adoption.

At the very end of its mandate however, the last National Assembly adopted a new Family Code which entered into force on 1 October 2009[19].

The innovations in the Family Code passed in 2009 (FC) are not enough in substance, nor in number to justify the passing of new legislation. They could have been made by amendments and supplements of the Family Code which has been in force from 1985 until now. Below these innovations are briefly outlined.

a) Entering into marriage

Most of the amendments are purely superficial and technical, but the FC includes some innovative regulation of the virtual legality (Rechtsschein) with regard to entering into marriage. If the marriage is officiated by a person who is not an authorized person for civil matters, the marriage is nonetheless valid.

b) Three alternative proprietary regimes

Firstly, the pre-existing matrimonial property status (joint ownership of subsequently acquired property) is preserved – until 2009, this was the only possible property regime between spouses. The only change in that regime is that it no longer applies to the personal savings of the spouses. From now on these (including those existing prior to the new FC) will be transformed into separate ownership.

Along with the matrimonial property two new regimes are introduced: the regime of separation and the contractual regime. The choice between separation or the contractual regime could be made initially at the time of entering into marriage as well as during an existing marriage.

If the choice of a regime has not been made, the regime of matrimonial property shall be applied.

The regime of separation is established by a declaration certified by a notary, while the contractual regime requires the parties to enter into an agreement, the signatures on which must be certified by a notary.

---

[19] D.V. 47/2009. The new Family Code entered into force on 1 October 2009.

The regime chosen is recorded in a special registry for property relations between the spouses, as a form of notice for the information of third parties.

All marriages are recorded in the registry, including those predating the new FC, as well as all changes of property regime. A check of the registry establishes whether a certain marriage is under a matrimonial property regime, regime of separation or contractual regime.

The matrimonial property and the regime of separation have a strictly regulated legal framework and cannot be modified. This gives third parties full legal certainty when they make a transaction with a spouse.

However, that is not completely the case with the contractual regime. In the registry, third parties can only see that a contractual regime is in place, but they cannot see the exact content of the matrimonial agreement. The matrimonial agreement itself is not recorded in the registry but is kept by the notary who certified the signatures. Therefore, third parties who want to make a transaction with one of the spouses have to request the agreement from the latter in order to establish what the real legal status is.

Conceived in this way, the regulation of the matrimonial agreement hides serious threats for third parties who, without qualified legal aid, are exposed to serious risks of misunderstanding, inaccurate interpretation of the matrimonial agreement and fraud concerning its content. The manner of recording the matrimonial agreement in the registry hides certain threats to the spouses themselves. These threats are highly specific, and will not be detailed here.

c) Divorce

Bulgarian law has traditionally recognized two types of divorce – contentious divorce and divorce by mutual consent. In the new FC from the 2009 the regime of the divorce is considerably liberalized.

The possibilities for the defendant to insist on preserving the marriage in the case of a petition for a divorce have been abolished. The obligatory proclamation of fault for the divorce has also been abolished. Divorce by mutual consent is considerably relaxed, the procedure is fast and at any given moment of the procedure of a petition for divorce the possibility remains to opt for a procedure of divorce by mutual consent.

The regulation for cancelling matrimonial donations after divorce has been amended. The new regulation cannot be analyzed one-sidedly as the possibility for cancellation has been expanded on the one hand, and on the other it has been reduced with regards to the grounds for cancellation. The legal technique employed for making the new rule (art. 55 FC) is far from being perfect and it is possible that it will not lead to a uniform practice in the courts.

d) Maintenance

The considerable amendment to the pre-existing act concerns the order of the persons who could request maintenance and the order of the persons who are obliged to give it (art. 140 FC). It has been established an absolute limit for minimum maintenance of a child and smaller maintenance cannot be determined. The other principles of maintenance are preserved.

5. Inheritance law

Disregarding some minor changes relating to restitution legislation, in practice, inheritance law[20] has not changed since the year 1949.

6. Commercial law (including banking and insurance law)

Along with the Commercial Act of 1991/1996[21], these are the Acts regulating:

- commercial register,
- public offer of securities,
- commodities exchanges and markets,
- companies of special investment purpose,
- acts regulating credit institutions and insurance companies

which will be dealt with by my colleague Tania Bouzeva.[22]

7. Privatization and restitution

In essence, this branch of law is one of transitory nature.

The seven restitution acts of general effect concern different properties subject to restitution (farm land, forests, shops, workshops and ateliers, town real estates nationalized under urban planning and nationalization undertakings, real estates of the catholic church, real estates of citizens of Turkish origin).

The legislation regulating privatization is enormous in volume, extremely unstable and discordant, considering the Act on Transformation and Privatization of State-owned and Municipal Enterprises[23], and the currently operative Act on Privatization and Post-Privatization Control[24].

---

[20] Inheritance Act, D.V. 22/1949, l.a. D.V. 47/2009.

[21] The Commercial Act was adopted initially (1991) only in its parts I (General Provisions), II (Kinds of Merchants) and IV (Insolvency); the III-rd part (Commercial Transactions) was adopted 5 years later, in 1996.

[22] See *infra*, pp. 351 et seq.

[23] D.V. 38/1992, l.a. D.V. 28/2002.

[24] D.V. 28/2002, l.a. D.V. 42/2009.

However, alongside these, the Bulgarian legal firmament has its blinking and fading regulatory acts dealing with compensation instruments; privatization funds and bonds, and mass and cash privatization. These acts caused sincere disgust in legal professionals, and have finally brought about a complete lack of interest on the part of most citizens in participating in these ambiguous processes.

8. Private international law

Undoubtedly, the most important domestic legal act in this branch of law is the 2005 Code of Private International Law[25], whose creation owes much to the great merits of the Hamburg Max Planck Institute, and the personal merits of Mrs. Christa Jessel-Holst. Its introduction was the first time in the 125 years' history of the Bulgarian legal system that a Code has integrated the matters of private international law. However, two years after the adoption of the Code, Bulgaria became a member of the EU, leading to the Code was largely displaced by the seven European regulations applicable to Bulgaria.[26]

Currently, for relationships which involve

- a Bulgarian and a European element, the Regulations apply; as for the matters not covered by the Regulations, the Private International Law Code (PILC) applies;
- a Bulgarian and an extra-European element, the PILC applies;
- as regards a number of States, bilateral treaties on legal assistance apply. Nonetheless, the thrust of some international conventions in the field of private international remains unclear.

9. Consumer law

This branch of law is relatively new to the Bulgarian legal system (although separate norms of protective nature can be found as early as the beginning of the 20th century). The new and relatively coherent regulation[27] has been adopted under the influence and pressure of European law.

However, this regulation has not been earned – it was totally "imported" from outside. That is why it reveals the typical weaknesses of any granted freedom and any unearned achievement. In spite (or perhaps as a result) of

---

[25] D.V. 42/2005, l.a. D.V. 47/2009.

[26] See the introductory notes to the edition "International Private Law", Part I (Международно частно право, част I)., 3rd edition, Sibi, 2009 by Musseva, B., pp. 10–11.

[27] The main and most important Act in this field is the Consumer Protection Act, D.V. 99/2005, l.a. D.V. 42/2009. It is however not a codifying act, because of the existence of numerous further dispersed regulations in dozens of legal acts.

closely following the respective Directives in this field, Bulgarian regulation has the following weaknesses:

- *Incomprehensibility*, which is apparent in some cases of poor translation of the Directives;
- *incoherence* with the remaining part of the legislation, which arises from the mechanical introduction of an alien model (a Directive) into the organism of national law;
- *gradual fading of the codification idea* in consumer law – along with the Consumer Protection Act (CPA), which is consistent by nature, separate provisions "swarmed" in the Tourism Act, Consumer Credit Act, E-trade Act, and there appeared a lot of provisions regarding advertising of various types of products.

All this is combined with a lack of interest, unawareness and inactivity on the part of consumers. It was not until the most recent couple of years that consumers started to realize their rights and dare enforce them. This revealed the unfortunate face that injured interests are comparatively unimportant and not worth defending through the courts.

The big problem for the Bulgarian consumer law may not differ too greatly from the difficulties faced by the European consumer law. Like an infection carried in the blood, the one affects the other. Therefore, Bulgarian consumer law – just like its European counterpart – suffers from a lack of a systematic approach; inner controversy; excessive measures; inadequacy of means and vagueness of the boundaries which the legislator is entitled to reach.

The extent of this negativity is easily seen in a comparison between the classical and "pure" PECL and the DCFR[28], which abounds in acquis communautaire admixtures.

The structure of the CPA resembles more a collection rather than a system.

Firstly, it has provisions regulating duties to inform for the benefit of the consumer. However, in the case they are not in any way "general rules" of "information legislation", but specific regulations such as type of labelling, user guides and price labelling, i.e. all concerning tangible property. Thus CPA does not make the connection and does not contain provisions for many specific cases (such as bank services, payment operations). There are special supplementary and varied provisions scattered through the CPA that do form a sort of systematic approach to the information which must be provided to the consumer, (for instance when entering into consumer contract, concluded outside the merchant location – art. 46, distance-

[28] For the latest version of the DCFR see Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference, outline edition, Sellier, 2009.

selling – art 52, 54, notifications for price reduction – art. 63–65, time-sharing – art. 151). There are of course other legislative duties regarding information dispersed throughout other legislation – for instance the Electronic Commerce Act, Credit Institutions Act and the continually multiplying regulations of the capital markets.

Therefore, the regulation of information provisions in the CPA cannot claim to be sufficiently systematic, nor complete.

The CPA regulated the misleading and comparative advertisement until 2007, which is now regulated in art. 32–34 of the Competition Protection Act[29].

In compliance with the European directives the CPA also regulates contracts entered into outside the merchant location (art. 43–47), distance-selling (art. 48–61), illicit means of sale (art. 61a–68a) and disloyal commercial practices (art. 68b–68l).

A major part of the provisions of the CPA (art. 69–142) are concerned with sales to consumers. This regulation creates a regime parallel to the general regime of sale in art. 183 and subsequent provisions in the AOC. The basic differences between the general regime and that of the consumer sale are in the following ways:

- defects (under AOC) are almost a complete mirror image to that detailed under "non-complicance" (under CPA);
- the number and volume of rights for the seller relating to defect/non-compliance in the classical and the consumer regulation are the same;
- despite the buyer having complete freedom to choose which one of his rights to exercise under the classical regime, under consumer sale, the exercise of rights follows a strict and cascaded hierarchy (repair-replace-price reduction-rescission);
- to compensate for the restrictions on the exercise of rights, the statutory time frames have been extended for non-compliance (2 years under CPA as against 6 months under AOC)
- This time extension however, does not constitute an unconditional benefit: a presumption (for the benefit of the consumer) of non-compliance from the moment of sale is only operative for the first 6 months (and that it has not been provoked by the faulty actions of the consumer himself).

In conclusion, the Bulgarian legislator gives to the consumer with one hand and takes with the other. Therefore a naive extolling of the European beneficial influence is not appropriate in this case.

The legislation introduced with respect to European law regulation has not extended to the liability for defective goods, i.e. that type of non-

[29] D.V. 102/2008, l.a. D.V. 42/2009.

compliance that causes damage outside the good to other property and persons. The damages caused by the purchased goods have not been regulated in Bulgarian law but have been given a particular and unsystematic regulation by case-law.

The second core of the CPA – along with the regulation of consumer sales is the regulation of discriminatory clauses in consumer contracts (143–148). This has, shortly after being passed, also been decodified. Special prohibitions for discriminatory clauses in the Consumer Credit Act and the Payment Services and Payment Systems Act were added to those provisions already included in the CPA.

Lastly, the CPA introduces regulation for timesharing agreements (art. 149–161).

III. The influence of the European (private) law

First of all, it should be stated that the meaning of the term "European private law" is not fully clarified.

The most significant impact of European law upon the Bulgarian legal system concerns its administrative aspect, especially specific requirements regarding certain products.

Considerable influence has been exerted by European company law upon the Bulgarian Commercial Act; however, this will be considered in detail by my colleague Tania Bouzeva.[30]

In the field of private law, probably the most important "transplant" is consumer law, which has just been considered. The largest part of the European Directives on consumer protection are "codified" in the Consumer Protection Act.[31] However, in recent times this concealed attempt at codification has continued to fail because the regulation is spread across a number of other acts as well.

The result of the long ongoing harmonization of Bulgarian law with the European law – almost constantly painful, yet having some, moderately satisfactory, results – is regulation of enormous volume and poor quality, which has lost its systematic structure.

Thus, currently operating in Bulgaria are:

- 334 acts and
- 2 478 subordinate legislation instruments.[32]

---

[30] See Bouzeva, *infra*, pp. 351 et seq.

[31] See *supra*.

[32] Data collected by the author himself, due to the lack of official statistics in this field.

Maybe these numbers do not seem frightening, but one should add thereto all the

- Regulations of the bodies of EU/EC/EEC, the number of which I dare not know.

The evil does not end here. It is supplemented by "the necessary evils" arising from the practice of the European Court of Justice, which can supplement and modify the literal meaning of legal prescriptions.

However, the big problem is not the quantity, but the instability.

The latest National Assembly has adopted 221 acts within a year (2005–2006), one half of which (113) are not new– they are amending Acts. In other words, one half of the legislative produced is worthless in principle and has to be constantly remade.

Some of the most drastic cases of this endless amendment[33] process involve

- the Commercial Act – 44 times (2,5 times a year);
- the Act on Ownership and Use of Farm Land – 46 times (2,5 times a year);
- the Civil Procedure Code (repealed) – amended 68 times, 50 of them being in the last 18 years (3 times a year in this period);
- the Civil Procedure Code (new, operative for one year exactly), which has already been amended 5 times (5 times a year);
- the 1991 privatization legislation, which at the legal level only has been amended more than 60 times (about 4 times a year).

All this takes place against a background of the burial of about 250 Acts, repealed within the period 1990 – 2009.[34]

IV. Pros and Cons of Codification

In Bulgaria it is traditionally assumed that the absence of civil codification is a serious weakness of the legal system. It is probably this view that constantly gives life to new codification initiatives.

In the 1970's a draft Civil Code was developed. However, in spite of its worth, it gradually sank into oblivion. Its revival would hardly make sense today, as it is morally outdated.

In the year 1999 several jurists of retirement age, who were close to the ruling authority, publicized a serial draft of the Civil Code. The draft was a

[33] Data are current as to the end of February 2009.

[34] Data collected by the author himself, due to the lack of official statistics in this field.

purely mechanical aggregate of the acts operative in the Bulgarian Kingdom at the beginning of the 20th century. The draft contained detailed regulation for bee swarms leaving a hive, however, it did not have even one single provision for dealing with the new ways of concluding contracts via Internet.[35] Soon after the draft was publicized, the ruling authority was no longer in power, and thus the damage was limited.

Recently – in the midst of the government's mandate[36] (about the year 2006) – the idea of codification emerged again. This time matters were set on a more serious basis – a group was formed with the Minister of Justice which had to answer the question whether it was necessary to adopt a new Civil Code. For the time being the results of the work of this group are unclear. Probably, the latter will not outlive the end of the present legislature's mandate.

The impression I have is one of vague objectives, unspecified means and dubious motivations of those aiming at codification of civil law.

The advantages of codification are clear – stability and consistency of law, and systematization of matters. However, the disadvantages are less frequently discussed. Stability may degenerate into fossilization, consistency may remain only within the Code and be totally missing from the special acts; systematization may turn out to be an ignis fatuus, and the texts of the "single code" may be derogated by the court practice contra legem.

What is meant? Let me explain it using an example.

In Bulgaria the basic regulation of sale is found – as might be presumed – in the AOC[37]. However, if the sale is a commercial one, the supplementary derogating rules of the Commercial Act[38] (CA) will apply to this regulation. If an international element is added, the regulation of both the AOC and the CA will turn out to be inapplicable, as that is the realm of the Convention on International Sale of Goods. And lastly, if the buying party is a consumer, none of the said acts will apply – falling instead under the Consumer Protection Act[39]. However, if the party concerned is the seller (for instance, in a shop selling second-hand goods), it is again the good old AOC that will apply. And so, the circle – which turned out to be a rather broad one – closes. However, upon closing it does not cover everything. Because, if leasing was chosen, instead of the classical purchase and sale,

---

[35] For criticism of this draft, see Popov, P. and Takoff, Chr., About the draft for a new Civil Code, redaction from September 1999, in Търговско право, No. 1/2000, pp. 3 –8.

[36] The former government is meant, the mandate of which ended in July 2009.

[37] Art. 183 ff.

[38] Art. 318 ff.

[39] Art. 69 ff.

and that leasing was financed by a third person, then the Consumer Credit Act will "show its colours" as well. And if the subject matter of the sale is securities and not goods, the Act against Market Abuse of Financial Instruments[40] will apply, the latter derogating the rules on invalidity in cases of bad faith (error and deception) and reducing the conflict with law – from a ground for voidance – to an almost innocuous administrative sanction.

Further complicating matters, if the item of sale is food, and the said food is a banana, the European regulation on the form, spots and curvature of bananas – European by origin and insane in its essence – will have to be applied.

This example illustrates another particularity typical of both the present time and the Middle Ages. Bulgarian contract law starts to resemble mediaeval guild law. It consists of at least three regulatory complexes – business to business, business to consumer, consumer to consumer. Only the last one of them – consumer to consumer – is regulated by classical contract law. The other two fields are regulated by commercial and consumer law, respectively.

Ultimately, what is left of the advantages of codification? Stability is missing, inconsistency is immanent, systematization is impossible. It is not codification time now. The world is not orderly; law cannot be orderly, either. The European legislator is not quite sure of the direction he has taken.

I will take the liberty of illustrating that point using a typical example. For a number of years the accessibility of information has been regarded as a panacea, and was assumed to be the consumer's salvation. Recently, it has turned out that the easiest way to achieve consumer disinformation is to flood him with information of indigestibly immense volume. This will require that whole fields of consumer law be reconsidered, and very soon.

In this respect, if a comparison is made between PECL and DCFR (which includes large amounts of text due to the intervention of Acquis Group) it becomes clear that the influence of European law upon classical civil law is neither always, nor necessarily favourable.

And now, returning to Bulgaria, I have to draw the conclusion that – probably, darkening the colours a little – the authors of the Code's drafts have one main goal – to immortalize themselves, albeit in a Herostratic way.

In order to finalize my pleading against the codification of civil legislation, I will submit one more – purely pragmatic – argument taken from the very recent past. It has been one year since Bulgaria has had its new

[40] D.V. 84/2006, l.a. D.V. 52/2007.

Civil Procedure Code[41]. Probably, many of the ideas of some of the creators of this new Code were pure and bona fide ones. However, the final outcome is more than disappointing. The principle of ut desint vires tamen est laudanda voluntas is not valid in law and legal technique. The new CPC has yet to disclose its numerous weaknesses. The legislator has yet to correct its errors (until now, for one year of operation, it has undergone no less than five[42] amendments). However, what is irreparable, is 1) crossing out with a sweep the whole court practice under the previous CPC, and 2) striking out – with a sweep, again – the only valuable textbook of Bulgarian civil procedure,[43] which, I'm afraid, will remain the only worthful one for an indefinite time into the future.[44]

[41] D.V. 59/2007, l.a. D.V. 47/2009.

[42] Meanwhile, for the time between March 2009 and July 2009 (less than 5 months), the amendments amounted already up to 9(!).

[43] See Stalev, Zh., Bulgarian Civil Procedure Law, ed. 1–ed. 9.

[44] The paternity of the new CPC is denied by all those who earlier – with overt or hidden pride – used to claim it. Of the three arguments for its adoption: 1) we have already made it; 2) Europe wants it, and 3) money was granted for the draft, we have spent it, and it would be a shame if everything is brought to naught – the first argument is strange, the second one – deceitful, the third one, disgraceful. So, I do sincerely hope that soon we will not have to listen to such or similar argumentation in connection with – God forbid – a new Civil Code.

C. Property Law Aspects – South-Eastern Europe

Property Law Reform in Croatia Between Legal Transplants and Autonomous Development

TATJANA JOSIPOVIĆ

I. Introduction

Croatia's private law system began a period of intensive development with the declaration of sovereignty and independence in 1991. The previous public ownership model, of self-managed socialism and the collective administration of the economy were abandoned, and a complex process of political, economic and legal reforms began. A free market economy was introduced and Croatia started to develop the modern private law system

needed for this type of economy. Privatisation and denationalisation were carried out and the system of social ownership was abolished. Many new laws and regulations have since been adopted in the areas of law relating to commerce, real property, obligations, family, succession, finance and bankruptcy. Parallel to private law codification, it was necessary to adjust the legislation for a free market economy and to harmonise it with the *acquis communautaire.*[1] Harmonisation activities were particularly intensive in 2005 when Croatia officially started negotiations for its accession to the European Union.[2]

II. General Survey of the Croatian Private Law System

1. A Historical Survey of the Croatian Private Law System

Until 1945, the Croatian private law system had developed predominantly under the influence of Austrian private law and was at the same level as all other contemporary legal systems in Central Europe. The most important law was the Austrian ABGB (Austrian Civil Code, ACC) which had been applied in the Croatian territories since 1853. Furthermore, the land register, civil proceedings, *ex parte* proceedings, the service of notaries public and a number of other services were also organized around the model provided by Austrian law. The ACC had been applied as the main source of legislation for Croatian civil law norms ever since it was introduced in certain Croatian territories[3] and continued to apply until the end of World War II.

After 1945, the Croatian private law system was no longer part of the circle of continental European legal orders and became a component part of the legal circle of socialist countries. The development of the entire legal system (and thus of its private law component as well) was aimed at

---

[1] The process of adjustment to the *acquis communautaire* started within the framework of obligations that Croatia accepted by signing the Stabilisation and Association Agreement between the Republic of Croatia on the one part and the European Communities and their Member States on the other (Official Gazette NN – International Agreements, 14/01). See the English version at <http://narodne-novine.nn.hr/clanci/medunarodni/328068.html>.

[2] More about the process of negotiations at <www.eu.pregovori.hr>.

[3] The Austrian Civil Code (*Allgemeines Bürgerliches Gesetzbuch/ABGB),* which is called *Opći građanski zakonik/OGZ)* in the Croatian language, was gradually introduced in certain Croatian territories in the long period from 1812 to 1853. It was introduced in the territory called the "Croatian Military Border" in 1812, in Istria in 1815, in Dalmatia in 1816 and in other parts of Croatia in 1853. For further details, see Gavella, N.: Die Rolle des ABGB in der Rechtsordnung Kroatiens, Zeitschrift für Europäisches Privatrecht, 4/94, s. 603 et seq.

the development of a socialist society. The main features of the legal system at the time were collective social ownership and a planned economy. This had a negative impact on the subsequent development of private law which, because of its foundation on individualistic concepts of the right of ownership and the autonomy of individuals, did not correspond to the accomplishment of the collectivistic goals of the socialist legal concept. Many classic legal institutions and private law principles were deformed and many traditional private law rules were repressed or modified.[4]

As opposed to public law, which assumed a dominant role in the socialist legal order, private law became extremely marginalised. Private law legislation therefore developed at a very slow pace. For this reason, even at a time when Croatia was a part of the socialist legal order, the ACC still played a very important role in the regulation of private law relationships. This was apparent in that the provisions of the ACC continued to be applied in practice, despite the fact that the ACC had "lost its legal force" as the result of the Act on Invalidity of Regulations Adopted Prior to 6 April 1941 and During the Occupation.[5] However, the ACC provisions were no longer applied as positive law but only as "legal rules".[6] Private law relationships that were not provided for in the positive body of law were regulated in accordance with the content of the ACC provisions. With time, some ACC provisions lost their meaning where private law relationships were concerned. Eventually, a number of the ACC provisions could no longer be applied to the new legal relationships arising from the dominant impact of the collectivistic socialist legal order (e.g. public ownership relationships). A number of new regulations were adopted to provide for particular private law segments and they gradually eliminated the need for the application of the relevant ACC provisions.[7,8] However, some private

---

[4] For real property law see III.3 below.

[5] Official Gazette of the Federative National Republic of Yugoslavia (FNRY) no. 86/1946.

[6] The ACC provisions were applied as legal rules on the basis of Article 4 of the Act on Invalidity of Regulations. Their application was permitted where legal relationships were not provided for in the positive regulations, namely where the existing loopholes in the legislation had to be closed. Even then, their application was possible only if the legal rule to be applied did not conflict with the regulations of the new legal order.

[7] As early as 1946, a Basic Marriage Act was passed followed by an Inheritance Act in 1955. The Obligations Act was passed in 1978 and the Act on Basic Ownership Relationships in 1980.

[8] In the former Socialist Yugoslavia, there was no unitary Civil Code providing for the most important private law segments. At that time, it was not possible to introduce a Civil Code because of the complicated division of jurisdiction of individual private law segments between the Federation and its socialist republics. The jurisdiction changed with time and the republics progressively assumed jurisdiction for the regulation of indi-

law segments remained unregulated in positive law until the end of the socialist period and the ACC provisions continued to be applied as legal rules.[9]

2. The Idea of Codification

After the independence of Croatia and the introduction of a market economy development began on a modern private law to correspond with the new economic system. A reintegration of the Croatian private law system into that of the Continental Europe (in particular Central Europe, i.e. the German circle) took place. The aim was to bring the Croatian private law system back into the circle to which it had historically belonged before 1945. The main idea behind codification was to establish a new private law system based on private ownership and entrepreneurial and market freedoms as the basis of the new economic, legal and social structure of the Republic of Croatia. A particularly important task was to harmonise the Croatian private law system to the *acquis communautaire.* Ever since Croatia acquired the status of a candidate country for the European Union, the harmonisation of Croatian law with the *acquis communautaire* had become one of the priorities of Croatian legislative reform. Every year, Croatia adopts a National Programme for the Accession to the European Union, which contains an annual plan for the harmonisation of Croatian legislation with the *acquis communautaire.*

3. The Process of Codification

The reform of the Croatian private law system has been developing progressively. The process did not begin with the adoption of a comprehensive civil code.[10,11] Instead, the legislature opted for a segmented approach

---

vidual private law segments (family law, succession law, condominium ownership and housing law, et al.).

[9] For example, the provisions of the ACC were applied in contracts for gifts and donations, loan contracts and servitude contracts.

[10] Ever since the initiation of the reform, some legal theorists have advocated the development of an integrated Croatian Civil Code (see Gavella, N.: Theses for a Development of an Integral Croatian Civil Code, *Zakonitost,* 5/1992). However, the proposal has never been discussed at an academic level or within the institutions responsible for the implementation of legislative changes.

[11] Such a process of codification was mostly justified by the need to lay down appropriate regulations for those private law areas that were essential for the development of a market economy and whose previous structure, because of its foundation in the socialist body of law, did not respond to the needs of a market economy. To some extent, such a segmented approach resulted from the complex structure of the previous Croatian private law system, determined by a division of responsibility for the adoption of private law regulations between the federal state and the republics as its constituent parts. At the

– individual private law areas were gradually regulated by separate acts. The first private law segments to be reformed were those whose regulation was a prerequisite for the smooth development of a free market economy (company law, property law, labour law, etc[12]). Other legal areas which did not have a crucial impact on the economic development of the country (e.g. succession law[13]), or those whose regulation had already corresponded to a market economy (e.g. contract law), were only reformed afterwards.[14]

At the legislative level, the reform has now been substantially completed. A large amount of new private law legislation has been adopted, covering the most important segments such as property law, land registration law, law of obligations, family law, succession law, commercial law and labour law.[15] The corresponding acts mostly followed the legal tradi-

---

time of the country's independence, the Croatian private law system had already been dispersed into a series of individual acts. Some of them were borrowed from the federal body of law and introduced into the legislation of the independent Republic of Croatia (e.g. Obligations Act, the Act on the Basic Ownership Relationships, Civil Procedure Act, et al.). Others had already existed in the legislation of the Republic of Croatia at the moment of Croatia declaring independence (the regulations concerning family and succession laws and others).

[12] For further details on the reform of company and labour laws see Borić, T., Petrović, S., Gesellschaftsrecht und Wirtschaftsprivatrecht in Kroatien, Wien 2000, p. 33−57, 214−323; Josipović, T., Rekodifizierung des Privatrechts in Kroatien, Kodifikation, Europäisierung und Vereinheitlichung des Privatrechts, Bratislava 2005, p. 213−216.

[13] The new Succession Act was passed in 2003 (Official Gazette NN 48/03, 163/03). For further details on the new succession law see Josipović, T., Das neue kroatische Erbrecht, WGO-Monatshefte für Osteuopäisches Recht, 2/2004; International Encyclopedia of Laws, Family and Succession Law (Suppl. 27 – Croatia) Hague 2005, p. 40−44, 191−268.

[14] The new Obligations Act (Official Gazette NN 35/05, 41/08) has been in force since 1 January 2006. It is the main source for the general law of obligations in the Republic of Croatia. It generally follows the tradition of the former Obligations Act of 1978. It has retained a monistic approach to obligations – the same rules apply to all contractual and extra-contractual relationships regardless of whether the contractual parties are merchants, professionals, or consumers. Where necessary, the Obligations Act expressly defines certain particularities relating to obligations among merchants. There is no special law in force in the Republic of Croatia which would provide for merchant relationships and which would, in its content, correspond to commercial codes existing in some other continental European legal systems. For further details, see Josipović, T., Anpassung des kroatischen Zivilrechts an europäische Standards, Privatrechtsentwicklung in Zentral- und Osteuropa, Wien 2008, p. 149−153.

[15] In a large number of cases, the preparation of new draft acts has been entrusted to working groups consisting of legal academics (university professors). They had previously been long involved in comparative studies of foreign legal orders and have been responsible for introducing many new solutions derived from foreign legislations into the

tion of the ACC and other Austrian regulations.[16] Even after Croatia's independence, the ACC has remained the main source of legal regulation for some property relationships (such as personal servitudes)[17]. The ACC provisions continued to serve as "legal rules" governing certain contractual relationships (e.g. the contract of gift and donation) and some property relationships (e.g. personal servitudes). The ACC provisions ceased to apply as "legal rules" only after the legal loopholes had been closed by corresponding positive regulations and after these private law relationships had been explicitly regulated.[18]

Aside from Austrian regulations, other foreign sources were also used as models in the process of private law codification because these were considered more modern and appropriate for a contemporary market economy. Thus, solutions from other related legislations of the German legal tradition (German and Swiss) were transplanted into certain new laws (company law, bankruptcy law).[19]

However, in some areas of private law, an autonomous development, free of any foreign influence, can still be found. This is particularly obvious in those areas in which a transition had to be made from an old (socialist) legal regulation to a new legal regulation,[20] as well as in areas in

---

new Croatian laws. However, it must be emphasised that most of the new private law codification was carried out within domestic working groups without significant foreign assistance (either technical or legal). Nevertheless, foreign technical and legal assistance in Croatia is of particular importance for the development of a new legal system within various projects of the reform of the judiciary financed from the State budget, World Bank loans and EU funds. For further details, visit <www.pravosudje.hr>. On the role of foreign technical assistance see Mistelis, L.A., Regulatory Aspects: Globalization, Harmonization, Legal Transplants, and Law Reform – Some Fundamental Observations, International Lawyer (2000), p. 1063 reproduced on <www.cisg.law.pace.edu/cisg/biblio/mistelis.htlm>.

[16] For real property law see III.3 below.

[17] The legal foundation for the application of ACC norms as legal rules was the Act on the Application of Regulations passed prior to 6 April 1941 (Official Gazette NN 73/91) and the Act on the Adoption of Obligations Act and the Act on Ownership Relationships into the Legislation of the Republic (Official Gazette NN 53/91).

[18] For example, the contract of gift and donation is now regulated in the Obligations Act (Articles 479−498). Personal servitudes are regulated in the Act on Ownership and Other Property Rights (Articles 199−217).

[19] A similar approach was reflected in legal, professional and academic literature in which the new regulations were analysed. In their commentaries, the authors used foreign literature and case law from the legal order from which a particular legal institution was adopted. When the legal institutions adopted from the ACC and other Austrian regulations valid in the Croatian territory prior to World War II were at issue, legal commentaries by older Croatian lawyers of that time were used.

[20] Thus, for example, separate laws were passed on the transformation of socially owned enterprises, as were regulations on the restitution of property and regulations on

which the modernisation of private law relationships was conditioned by the development of social and family relationships rather than directly by a transition to a market economy.[21]

This segmented approach in the process of codification has had a significant impact on the actual structure of Croatian private law codification. Croatia still lacks a comprehensive and unitary civil code by which all civil law issues could be thoroughly and systematically regulated. The most important feature of the present private law reform has been the adoption of separate laws rather than the adoption of an integral civil code. At this point, there is no project aimed at the preparation of a civil code draft. There have been no concerted efforts at the academic or legislative levels to bring about a code as the basis for a future systematic development of the private law system. Furthermore, no discussions have taken place on the possible content of a civil code or its underlying concepts or principles. The segmented approach to the regulation of individual private law areas without their unification into a comprehensive civil code still remains the main feature of the private law legislation in Croatia today.

Nevertheless, some areas of private law have developed independently in the Croatian private law system through the adoption of new laws or by amendments to existing ones. These consist of a series of new and thoroughly amended laws which regulate various private law segments. All these laws are of the same rank and their mutual relationships are construed in accordance with traditional legal principles such as "*lex posterior derogat legi priori*", "*lex specialis derogat legi generali*". As a result, and in the absence of a unitary civil code, the private law segments of the Croatian legal order do not form a logical and functional whole (not even

---

the transformation of social ownership. For further details on transformation and privatisation see Borić/Petrović (*supra* note 12), p. 199−214.

[21] Thus in the new Inheritance Act, the freedom of testamentary succession was extended, narrowing the circle of forced heirs, and extending the circle of legal heirs to include extra-marital spouses, a register of wills was introduced, and notaries public were authorised to conduct inheritance proceedings. For further details see International Encyclopedia of Laws, Family and Succession Law (Suppl. 27 – Croatia), p. 216, 224−238, 264. In the new Family Act, the previously adopted principles of equality of children born in wedlock and those born out of wedlock have been kept, as well as equality between marital and extra-marital spouses in real property relationships. In addition, the rights of children are regulated in accordance with international conventions on the rights of children. A separate Act on Same-Sex Partnership was adopted (Official Gazette NN 116/03), providing for relationships in same-sex unions (the obligation of maintenance, property relationships, etc.). For further details see International Encyclopedia of Laws, Family and Succession Law (Suppl. 27 – Croatia), p. 132−145, 170, 172.

those traditionally considered components of civil codes in European countries with a long civil code tradition).[22,23]

Such a segmented development of certain private law areas has had a negative impact on the consistency of Croatian private law regulation, in particular on the uniform application of individual regulations concerning private law relationships.[24] In particular, it is often extremely difficult to establish which law has precedence in the regulation of specific private law relationships. This is particularly manifest in cases in which several laws rely on the same legal concept, but provide different content in different private law relationships.[25] Even within the same private law area there are, aside from the main Act, many separate laws regulating individual aspects or parts of that particular legal field.[26] There are many situations in

[22] Some areas of private law traditionally considered as belonging to civil codes have become separate legal disciplines (e.g. family law, labour law) and they are studied in isolation from other private law areas (there are even separate departments at law faculties).

[23] This approach has resulted in a situation in which the "general part" (in German terminology) of civil law has still not been systematically regulated in the Croatian civil law body. Some provisions which traditionally belong to the "general part" of civil law have become part of the Obligations Act (e.g. the provisions on legal and business capacities, the application of customs and practice). These provisions are applied as the provisions of the "general part" of civil law pursuant to Article 14/3 of the Obligations Act.

[24] This fragmentation of the private law system has undoubtedly resulted from the fact that some areas of law have adopted various legal institutions from different legal orders. Although they are mostly legal orders from the same German legal family, there are significant differences among them which render their efficient application impossible in practice. A systemic codification of civil and commercial law would certainly contribute to the elimination of problems connected with the reception of foreign law. For further details see Ajani, G., "By Chance and Prestige: Legal Transplants in Russia and Eastern Europe", The American Journal of Comparative Law, Vol. 43, 1995, p. 106.

[25] A clear example is the different definition of the concept of "extra-marital union" in the Succession Act and in the Family Act. The Family Act of 2003 defines an extra-marital union as a life union between an unmarried woman and an unmarried man, not living in any other extra-marital union, and which has lasted for at least three years, or shorter if a common child was born within the union (Article 3). According to the Succession Act of 2003, an extra-marital union is a life union of an unmarried woman and an unmarried man which has lasted for a longer period of time and ceased to exist at the moment of the testator's death, under the condition that all the preconditions for a valid marriage had been fulfilled.

[26] The best example is contract law, whose general part and special contracts are provided for in the Obligations Act. However, besides the Obligations Act, there are a number of separate regulations providing for different types of contracts (Lease Contract, Rental of Dwellings Act, Business Premises Lease Contract, Consumer Protection Contract, etc.). For all such contracts regulated by separate laws, the Obligations Act is only a subsidiary legal source.

which different Acts regulate the impact of the same legal facts on the same private law relationships, their cessation or change quite differently.[27]

The segmented approach to the reform of Croatian private law is also manifest where laws introduce new areas into private law legislation (i.e. previously not regulated by private law norms). These are mostly regulations aimed at harmonising Croatian private law with that of the European Union. As a rule, harmonisation is achieved through separate laws through which individual directives are implemented into the Croatian legal order. Very rarely, individual directives are incorporated into existing regulations, thus maintaining a consistent system of legal norms (at least at the level of a single segment of a private law regulation). A similar trend is also manifest in the implementation of directives governing contract law. In this case, the legislature decided not to establish a new and consistent contract law system alongside the implementation of individual directives, which could have been achieved by incorporating their contents into the general piece of legislation governing contract law – the Obligations Act. This approach was not adopted despite the fact that the adoption process for the new Obligations Act and the implementation process for numerous directives from the area of contract law took place at the same time. As a rule, the directives from the area of European contract law are now implemented in separate laws, so that the application of the Obligations Act is only of a subsidiary nature.[28] The directives dealing with the protection of consumers, including those regulating consumer contract law, are implemented in a separate Consumer Protection Act.[29] However, the Croatian legislature decided not to raise the rules for consumer contracts to a general level to make them valid for various types of consumer contracts. Even within the same area of regulation, the legislature opted for a segmented approach to regulate individual types of consumer contracts by adopting a literal translation of the content of a directive dealing with a particular consumer contract. For this reason, there is still no general system of consumer law providing for all contractual relationships, in which

---

[27] Thus the Enforcement Act (Official Gazette NN 57/96, 29/99, 173/03, 194/03, 151/04, 88/05, 67/08) states that the contract on renting a flat not entered into the land register ceases to exist after an enforced sale of the same flat (Article 83/2). On the other hand, the Rental of Dwellings Act (Official Gazette NN 91/96) expressly provides that in the case of a change of the flat owner (including the change resulting as the consequence of a sale), the obligations and rights arising from the contract of rental are transferred onto the new owner (Article 24/1).

[28] Only some directives that are important for obligations are implemented in the Obligations Act. For further details, see Josipović, T., Anpassung des kroatischen Zivilrechts an europäische Standards (*supra* note 14), p. 150.

[29] Official Gazette NN 70/07, 125/07.

one party is the consumer and the other a seller or other non-consumer entity. There is only one single provision in the Consumer Protection Act unifying the rules on individual consumer contracts provided for in the European guidelines.

III. Property Law Codification

1. A Historical Overview and Property Law Reform

Croatian property law is one of the areas of private law which, after the transition to a market economy, went through the most radical changes. When Croatia was part of the socialist regime, property law experienced major content-related and structural changes which led to a significant departure from continental European standards governing property law relationships. Ownership was regulated on the basis of a collectivistic concept,[30] and property law regulation was carried out in parts. On the one hand, there were two regulatory models for general property law concerning the appurtenance of property: social and private ownership. On the other hand, a number of property law regulations were established for particular types of objects such as building lots, agricultural lands and forest lands. Property, particularly real estate, was socially owned (e.g. building lots, agricultural land, forests, buildings, flats and so on). Unlike the right recognised in legal orders characterised by a market economy, there was no right of ownership for socially owned property. Nevertheless, various legal entities did have some specific subjective rights to this property (the right to use, dispose of and manage them), which appear to have been

[30] In the socialist period, for a long time there was no positive regulation for real property, so the ACC provisions were applied to real property relationships as legal rules. However, the ACC norms – as legal rules – could only be applied in a very limited sense. Their application was only manifested in the real property relationships that fell under the so-called private ownership (civil law) segment which was limited to a narrow circle of legal subjects of ownership and other real property rights, and only to the objects which could be privately owned. The Act on Basic Ownership Relationships (ABOR) was adopted as late as 1980. The Act provided basic provisions governing possession and some individual real property rights. Its importance in real property regulation at the time was significantly marginalised. The provisions of the ABOR were only applied in a very limited way – that is, to the real property relationships between legal subjects (who were holders of the ownership right and other real property rights) and the objects which were the subject of those rights. All other real property relationships not provided for by this Act continued to be governed by the ACC norms as legal rules (on personal servitude, for example). For further details see Gavella, N., Borić, T., Sachenrecht in Kroatien, Berlin 2000, p. 22, 23; Borić, T.: Eigentum und Privatisierung in Kroatien und Ungarn, Berlin 1996, p. 36−47; 52−55.

absolute and protected by law. In practice, those rights were frequently referred to as "new property rights" on socially owned property.[31]

Along with the abandonment of the individualistic regulation of ownership, other principles were also abandoned: the uniformity of the right of ownership, equality of all legal entities and the uniform treatment of all objects of ownership, as well as other property rights. When speaking of socially owned real estate, it must be mentioned that the principle of its legal unity (*superficies solo cedit*) was also abandoned in the regulation of legal relationships arising from the construction of a privately owned building on a socially owned plot. The building was then legally separated from the land, owned by a private person, whereas the land continued to be socially owned. The owner of the building was only entitled to use the land. The different parts of a piece of real estate (the plot, flats, common areas of the building) were subject to different rights belonging to different persons. This dualism in the regulation of property constituted a serious obstacle to the development of a market economy. Legal transactions involving property (and particularly real estate) were undeveloped, non-transparent, slow and performed under strict control of public authorities. Property and goods could not be transacted and even where this was possible, it was subject to heavy restrictions. Modern institutions of secured transactions appropriate to a market economy did not exist at all.[32]

The basis for property law reform was laid down in the new Constitution of the Republic of Croatia of 1990[33].[34] The Constitution proclaimed the inviolability of ownership as one of the highest values of the constitutional order of the Republic of Croatia (Article 3) and guaranteed the right of ownership as one of the fundamental rights of man (Article 48(1)). The current Croatian Constitution recognises only one type of ownership right; private ownership based on the concept of the individual and on the doctrine of the social component of ownership. This type of ownership gives its holder a total and exclusive private legal power over the possession. According to an express constitutional provision (Article 48(2)), ownership binds because owners are obligated to contribute to general welfare. The

---

[31] For further details on the types of rights on socially owned property see Borić (previous note), p. 64–75.

[32] It is interesting to note that the security interest in personal property in the socialist era was provided for in the Obligations Act of 1978 (Articles 966–996) and it was treated as a separate contractual relationship between a pledger and a pledgee. In the Act on Basic Ownership Relationships of 1980, adopted in the legislation of the Republic of Croatia upon its independence, there was not a single provision on the security interest in personal property.

[33] Official Gazette NN 1/01 – revised text.

[34] For further details on the essential importance of the constitutional framing for the transition to a free market economy see Mistelis (*supra* note 15), p. 1058.

Constitution also expressly provides that, when it is in the interest of the Republic of Croatia, ownership can be restricted or expropriated by law upon payment of compensation equal to its fair market value (Article 50(1) of the Constitution). The exercise of entrepreneurial freedom and property rights may be restricted by law as an exception, for the purposes of protecting the interests and security of the Republic of Croatia or for protecting nature, the environment and public health (Article 50(2) of the Constitution).

2. New Property Law in the Republic of Croatia

a) General Observations

Property law reform in Croatia was carried out through the adoption of the Real Property Act/RPA,[35] which entered into force on 1 January 1997. The RPA is considered to be the fundamental source of the new property law in Croatia.[36] It is based both on an individualistic concept of the right to own and on the traditional principles of the regulation of property, and is thus closer to other contemporary European legal orders. The most important steps in real property reform were the final abolition of social ownership and its transformation into private ownership,[37] as well as the return to traditional and fundamental continental European principles of real property regulation (the principle of *superficies solo cedit,* the principle of the protection of bona fide purchasers in legal transactions, the principle of the social component of ownership). Croatian property law is governed by the

[35] Official Gazette NN 91/96, 68/98, 137/99, 22/00, 73/00, 114/01, 79/06, 141/06, 146/08, 38/09, 159/09. For a German translation of the RPA (the version of 1 January 1997) see Gavella/Borić (*supra* note 30), p. 116−298.

[36] Besides the RPA, an important act for the regulation of real property is the Land Registration Act/LRA (Official Gazette NN 91/96, 68/98, 137/99, 114/01, 100/04, 107/07, 152/08). The LRA and the RPA entered into force on 1 January 1997.

[37] The transformation of social ownership over certain property had been carried out even before the RPA entered into force. It was carried out in such a way that the social entities that were holders of the rights over socially owned property changed their status and became private owners (e.g. the Act on the Transformation of Publically Owned Enterprises, Official Gazette NN 19/91, 45/92, 83/92, 16/93, 94/93, 2/94, 9/95). The transformation to private ownership was also applied to the rights such persons had had over socially owned property. Those rights were thus transformed into ownership rights for those persons who, prior to the process of privatisation, had had the right to use the same property. In the case of some chattels (e.g. agricultural land, forest land), social ownership ceased to exist on the basis of various separate laws making this property *ex lege* the possession of the Republic of Croatia. The process of transformation included restitution, whereby property that had been nationalised and confiscated was returned to its former owners (e.g. Act on the Compensation for the Assets Seized during the Yugoslav Communist Rule (Official Gazette NN 92/96, 92/99, 80/02, 81/02)). For further details on this see Borić/Petrović (*supra* note 12), p. 204−212; Josipović, T., Immobiliarsachenrecht in Kroatien, Wien 2002, p. 4−6.

following principles: the principle of absolute effect of property rights (*contra omnes*), the principle of a closed number of real property rights (*numerus clausus)*, the principle of specificity, the principle of publicity, and the principle of bona fide protection in legal transactions.

The most important provisions of the RPA deal with the regulation of ownership and its most important types (individual ownership, co-ownership/Miteigentum, common ownership/*gemeinschaftliches Eigentum* and condominium/Wohnungseigentum), including the types of acquisition, protection and cessation. All other property rights are defined in separate chapters (servitudes/Dienstbarkeiten, real charges or encumbrances/ Reallasten, the right to build/ Baurecht, security rights/dingliche Sicherheiten). The RPA provisions apply to these rights accordingly unless otherwise specified in other pieces of legislation.

The most important features of the new Croatian regulation on real property are the following: a return to the principle of a legal unity of real estate, an extension of the closed circle of property rights, increased protection of trust in legal transactions, a new regulation of secured transactions, transformation of social ownership, a separate regulation of the transition period (a transitory regime) for the property previously socially owned and for the creation of a legal unity of real estate.

b) A Return to the Principle of Legal Unity of Real Estate

In accordance with the principle of the legal unity of real estate, the RPA expressly provides that real estate consists of the land and whatever is reasonably and permanently attached to it, either on its surface or below it (Article 9 of the RPA). Whatever is built on the surface of a plot, above it or below it, and is meant to remain there on a permanent basis – or property that is built into the real estate, on it, or is in any other way permanently attached to it – is considered as a part of the real estate until detached from it (Article 9(3)). Grass, trees and fruits, as well as all other usable property produced on the land surface are considered parts of the real estate until they are separated from it (Article 9(2) of the RPA). Buildings or other objects erected on the plot for some temporary purpose (e.g. kiosks, stalls, booths, etc.) do not fall into this category (Article 9(3) of the RPA).

The regulation of legal relationships concerning real estate on the basis of its legal unity comes into play in any real property relationship. This principle must be observed for ownership arising through building on somebody else's land.[38] Because of the principle of the legal unity of real

[38] Thus the principle of the legal unity of real estate is also clearly manifested when acquiring ownership by erecting a building on the land of another, *in aedificatio*. A

estate, the statutory regulation of condominiums has also changed. It is now defined as a separate form of ownership over unified real estate (the plot and the building on it) whereby the condominium owner also exercises his or her co-ownership rights over a particular part of the real estate (a flat, business premises, and so on).

From the entry into force of the RPA, the principle of legal unity of real estate is valid in any legal relationship whose object is a piece of land on which a building is erected (Article 366(1) of the RPA). Any legal transaction in which the principle of legal unity of real estate is not observed does not have any legal effect (Article 366(3) of the RPA). The provisions of valid regulations with different provisions for the possession of buildings including their parts and for the possession of land may be interpreted and applied only in accordance with the principle of legal unity of real estate (Article 395(2) of the RPA). The rules which strictly define the concept of real estate, the principle of legal unity and its legal effects on any legal transaction, were above the level required at the time the RPA was adopted. In this way, the legislature sought to eliminate possible dilemmas and different interpretations of the concept of real estate in judicial and business practices. It was particularly important to eliminate the interpretation of the concept of real estate according to previous regulations in which the principle of legal unity of real estate was not observed. Therefore, exceptions from the principle of legal unity for real estate have expressly been stated in the RPA.[39]

The introduction of the principle of *superficies solo cedit* had a significant impact on legal transactions involving real estate. Since the entry into force of the RPA, legal transactions involving real estate have become much simpler because of its unified character: one can dispose of a unified

---

building erected without the knowledge and permission of the owner of the land becomes the possession of the owner of the land (Article 152/1 of the RPA). The same rule applies if the owner of the land had known of the construction, but had failed to ban it without any delay and the constructor acted dishonestly (Article 154 of the RPA). The principle of the legal unity of real estate comes into play when somebody adds to, builds on or reconstructs a building, builds additions to it, builds something into it, or otherwise invests in it. The only situation in which the principle of the legal unity of real estate does not come into play is when the constructor has been honest, and the owner of the land dishonest. An honest constructor who did not know, or could not know, that he or she was building on the land of another becomes the owner of the land by the act of having erected a building on the land of another, provided the owner of the land knew about the construction but had failed to act immediately to prevent its continuation, or provided that he let the construction continue so that the building be finally erected on the plot (Article 153 of the RPA).

[39] The legal separation of the land from the building is possible on the basis of the right to build and on the basis of a concession. In both cases, these are rights authorising their holders to own a building erected on the land of another.

piece of real estate because whatever is attached to the land or is added to it on its surface or below it must follow its legal course (Article 2(2) of the Land Register Act). An object permanently attached to the land is considered to be a component part of the real estate, thus constituting a legal unity which is an object of legal relationships until it is detached. In this way, legal transactions involving real estate have become both faster and safer and the preconditions for reaffirming the role of the land register in legal transactions have been created. The land register may now easily fulfil its functions in legal transactions (the functions of publicity, acquisition and protection of trust) whenever the plot of land is registered even when the building erected on it may not be registered yet.[40]

c) New Real Property Rights

In the course of the property law reform, the area of real property rights in the Croatian legal order became much wider. Two new real property rights were introduced: real charges (encumbrances/Reallasten) and the right to build/Baurecht. An encumbrance constitutes a real property right on a person's property that entitles the holder to a specific property or a performance using the property (Article 246 RPA).[41] The right to build is a real property right to another person's land authorising its holder to own a building erected on the plot or below its surface (Article 280(1) of RPA).[42] Some real property rights which used to exist in the Croatian legal order, but were not provided for in the positive regulations and the ACC rules, had to be introduced and finally became part of the existing regulation. Personal servitudes (persönliche Dienstbarkeiten) are now provided for in a separate part of the RPA and there is a distinction between the right to usufruct (*usufructus*), the right to use (*usus*) and the right to habitation (*habitatio*).

Among the new real property rights introduced in the course of the reform, special economic and social importance is given to the right to build. The need for this right arose after the reintroduction of the *superficies solo cedit* principle, namely, to introduce the right by which a legal separation of the possession of the plot and the possession of the building would be

---

[40] Because of the principle of the legal unity of real estate, all land register entries concerning the land relate to whatever is relatively permanently attached to it, regardless of the fact that it is not entered into the land register and regardless of whether it will be entered into it and when. For example, a registered owner of the land is considered the owner of the building, even though the building is not entered into the land register. A lien encumbers the land with the building even if the building is not registered.

[41] For further details on real charges see Gavella/Borić (*supra* note 30), p. 60−65.

[42] For further details on the right to build see Gavella/Borić (*supra* note 30), p. 65−69.

possible. The right to build makes it possible for ownership of a plot of land and a building on it to be vested in two separate people.[43] The owner of the plot and the holder of the right to build are free to determine their legal relationship concerning the plot and the building to suit their economic interests. The parties freely determine the duration of the right to build, preconditions for its termination, underlying conditions and similar aspects. The advantages of the right to build are particularly obvious in cases involving the disposal of real property owned by the state or by local government units. The right to build is becoming a frequently used legal form in Croatia for public-private partnership projects.[44]

d) Strengthening the Protection of bona fide Purchasers

A significant improvement in the regulation of real property rights in Croatia came about with the radical change of providing protection for bona fide purchasers (Vertrauensschutz) in legal transactions involving both chattels and real property, i.e. in acquiring ownership and other property rights by non-owners. The protection of the bona fide purchaser in legal transactions involving chattels has significantly increased. Pursuant to Article 118 of the RPA, protection is granted to an acquirer who enters *bona fide* into a legal transaction with a possessor of a chattel who is not the owner. The *bona fide* acquirer now owns the chattel, although his predecessor did not (Article 118 of the RPA). Exemptions to this rule are expressly provided for in the Act.[45] The provision on the acquisition of ownership over a chattel from a non-owner also applies to the acquisition of security interest over a chattel from a non-owner. (Article 317 of the RPA).

The protection of bona fide purchasers in legal transactions involving real estate is now expressly provided for in the RPA and in the Land Register Act.[46] The Croatian land register (Grundbuch) has therefore regained the role that the land register holds in all systems of the German legal

---

[43] Legally, the right to build is bound to a particular piece of real estate. A building erected on the basis of the right to build is a part of that right and not a part of the land (Article 280/3 of RPA).

[44] Cf. the Act on Public-Private Partnership (Official Gazette NN 129/08).

[45] The acquisition from a non-owner does not occur if a thing is stolen, if the owner has lost it or misplaced it (Article 118/4 of the RPA).

[46] For further details on the protection of bona fide purchasers in land registration see Gavella/Borić (*supra* note 30), p. 38, 39; Josipović, T., Das Grundbuchsystem in der Republik Kroatien – Merkmale, Funktionen, Reform, Das Cavtater Syposium "Beiträge zur Reform der freiwilligen Gerichtsbarkeit in den Staaten Südosteuropas", Bremen 2005, p. 78−82; Josipović, T., Länderbericht – Kroatien, "Flexibilität der Grundpfandrechte in Europa", Vol. I, (red. O.M. Stöcker), Berlin 2007, p. 177−179.

family.[47] With its key public function being the protection of bona fide purchasers in legal transactions involving real estate. The reform of the land register began at the same time as the reform of the real property system, and the protection of faith in land register is now provided for – for the first time – in Croatian regulations.[48] It is expressly laid down that the land register offers protection to honest acquirers who act in good faith relying on data contained in a comprehensive and authentic land register. Special attention has been paid to the definition of prerequisites for providing this protection to honest acquirers. The prerequisites and time limitations for bringing a suit for terminating a record of the land register against an honest acquirer are also specified.

As the courts, professionals and politicians had previously tended to marginalise the land register and deny its function in the process of acquiring property, the legislature opted for a special drafting approach to secure its position. Besides a general regulation for the protection of transactions carried out in good faith in the general part of Land Registration Act (Article 8), the same rules are now provided in the RPA, where the acquisition, protection and cessation of real property rights are defined, as are the prerequisites for the provision of these safeguards. The intention has been to eliminate the possibility that, in case law, rules on the protection of faith are re-interpreted in a way that the protection is reduced or abolished rather than increased.[49]

However, this approach to legal drafting did not eliminate all the operational problems of the land register prior to the entry into force of the RPA. At that time, in very many cases, the land register was not harmonised with the current legal real estate situation. This was mostly the result

---

[47] Croatia has a very long tradition of land registration. It was introduced in its territory as early as 1855. However, during socialism, the role of land registers for the acquisition of real property rights over real estate and the protection of bona fide purchasers was marginalised at both the legislative and case law levels. This is why today land registers are often incomplete and dated and do not reflect the correct situation concerning real estate.

[48] Prior to the adoption of OA and LRA, the laws on land registration of 1930 and 1931 of the Kingdom of Yugoslavia had been applied as "legal rules".

[49] For example, there were some problems in practice with the interpretation of the acquirer's good faith in the case of a multiple sale of real estate. An acquirer, in order to be honest, also had to check the non-registered (possessory) status of real estate. The acquisition of ownership over real estate by a possessory handover was also acceptable, without entering it in the land register. This was all contrary to the concept of the land register, which became marginalised as an instrument of the protection of trust in the legal transaction of real estate. Therefore, it is now expressly set out in the RPA that the acquirer cannot be held dishonest only because he or she had not checked the non-registered status of real estate. For further details see Josipović, T., Das Grundbuchsrecht in der Republik Kroatien, Wien 1999, p. 45, 49, 61.

of the total marginalisation of the land register and its role during the socialist era. At that time, it was possible to dispose of real estate without it being entered into the land register, transactions were not only tolerated, but recognised and enforced under the existing law of the time. In the meantime, a number of significant changes have taken place regarding the legal status of real property as a consequence of the transformation of social ownership into private ownership. The changes resulting from this should have been entered into the land register as well. An unconditional application of the rules protecting good faith could result in the loss of already acquired rights which, for various reasons (more or less justified), were not registered or were registered in the wrong way. Therefore, the legislature decided to postpone the application of the rules for the protection of good faith in land registers to provide enough time for real estate to be registered. Initially, this was for a period of 5 years from the entry into force of the RPA, but this was prolonged for a further 5 years and then again for an additional 3 years and finally for another 5 years. In short, in the case of socially owned real estate, the application of the rule for the protection of good faith was postponed until 1 January 2015 (Article 388 of the RPA). Prior to this date, no acquirer of real estate that used to be socially owned could rely on the rule protecting good faith.[50] The postponement of this rule has had a negative impact on legal transactions, the failure to provide protection to honest acquirers has made legal transactions involving previously socially owned real estate insecure. Prior to entering into a contract involving real property, parties must establish whether there are any unregistered rights and encumbrances on a piece of real estate, whether the registration is valid, taking care to manage these and other considerations. These investigative procedures slow down the transaction and make it more expensive. The postponement of the application of the rule on the protection of good faith does not correspond to the establishment of efficient transactions suited to a free market economy.

e) The New System of Secured Transactions

The integrated regulation of secured transactions was an important step in property law codification. Its most important feature is the increased protection of creditors, during both the establishment and the enforcement of secured transactions.[51] This was a significant breakthrough in the adjust-

[50] The rules on the protection of trust in land register now apply fully to real estate which was already privately owned prior to the entry into force of the RPA (1 January 1997). For further details on the postponement of the protection of trust in land register see Josipović, Das Grundbuchsystem in der Republik Kroatien (*supra* note 46), p. 82−88.

[51] For further details see Gavella, N.: Kreditsicherung durch Rechte an Liegenschaften nach dem neuen kroatischen Recht, in: Systemtransformation in Mittel- und Osteuropa

ment of property law to a free market economy in which the secured transactions of various market activities played an extremely important role. A central place among secured transactions in the RPA has been given to mortgage law. Here the preconditions for acquisition, the powers of the mortgagee, the enforcement of the secured party's rights and the termination of security interests are expressly regulated for every object of a security interest (chattels, real estate, intangibles) depending on the legal basis of acquisition. The basic characteristics of mortgage law are as follows: absolute effect (erga omnes, contra omnes), publicity, accessibility, specificity (the claim and the charged land must be specified), encumbrance of an object/right by security interests with all appurtenances (growth, fruits), inseparability of security interest from the encumbered object (a security interest cannot exist separately from the encumbered object), transferability of a mortgage (a mortgage may be disposed of by transferring it to a new mortgagee together with the secured claim by encumbering the mortgage with a sub-mortgage) and enforceability (compensating the mortgagee in court proceedings, or in some other legal way, such as sales organized in the form of public auctions).

In addition to the mortgage, the RPA lays down another form of security interest in the form of a fiduciary transfer of ownership or retention of title as separate legal instruments for securing claims (Article 34(5) of the RPA). Consistency for real property security interests in the RPA has been enhanced by mortgage provisions being applied accordingly to the transfer of ownership as a form of security, as well as to any other forms of secured interest by encumbered objects, debtors or third persons, unless otherwise prescribed by law (Article 297(2) of the RPA).

f) Transition to a New Real Property Regulation

The establishment of a real property system based on only one type of ownership (private ownership) and a return to the principle of legal unity of real estate required special regulation to transition existing social ownership to the new system. The regulation of this process of transition constituted one of the most complex tasks of real property reform. Due to the specific type of social ownership, no corresponding model could be found among existing foreign legal orders. On the one hand, it was necessary to establish a transitory system with maximum recognition of the principles of acquired subjective rights over socially owned property. These rights, despite the fact that they had existed over socially owned property, had proprietary and economic value that had to be preserved during the

---

und ihre Folge für Banken, Börsen und Kreditsicherheiten (eds. Drobnig/Hopt/Kötz/Mestmäcker), Tübingen, 1998; Gavella/Borić (*supra* note 30), 69−95.

transition to a new real property regulation. On the other hand, the transition had to be structured in such a way as to ensure a speedy and simple, but legally secure, transition to the new regulation of ownership. The legal effects of the transition were set in ex lege, i.e. by the entry into force of the transitional and final provisions of the RPA (1 January 1997). Such an approach, however, called for a very detailed regulation of the transitory regime. It had to be diversified while taking into account the type of legal relationship involving socially owned property, establish who the holder of the right was, and many other aspects.

The establishment of a real property system based solely on private ownership required a cessation of subjective rights on socially owned property. Those rights could only be transformed into the right of ownership or some other right provided for in the RPA. On the basis of the transitional and final provisions of the RPA (Articles 354–365), rights over socially owned property were transformed into the right of ownership whereby their holder is known. The owners of property that used to be in social ownership (ex lege) (or their heirs or other legal successors) now had rights over the socially owned property. All holders of these transformed rights were able to protect and prove rights acquired through the process of transformation in accordance with the general rules on the protection of ownership. After the transformation, these rights retained their previous priority (Article 389(2) of the RPA).

The establishment of a legal unity for real estate also required special transition in all cases where the land and the building had previously been legally separated. On the basis of special transitional and final provisions governing real estate, legal unity, abandoned in the socialist regime was now ex lege re-established through the transitional and final provisions of the RPA. By the entry into force of the RPA (1 January 1997), the legal unity of real estate was established in such a way that the land and the building erected on it became unified real estate (Articles 366–373 of the RPA). The owner of the building erected on socially owned land prior to the entry into force of the RPA then became the owner of the land on which the building was erected. Due to the fact that the principle of legal unity was also abandoned in the regulation of ownership on separate parts of a building (condominiums), when the RPA entered into force, the condominium also regained its legal unity. When the RPA became effective, the owners of flats became the co-owners of the entire property (land + building) and their legal position was also governed by the provisions of the RPA governing condominiums (Articles 66–99 of the RPA).

3. Legal Transplants in Real Property Law

The codification of Croatian real property law was strongly influenced by the ACC. Some legal concepts were taken from German real property regulation while other solutions resulted from the autonomous development of Croatian real property law. Most deviations from the Austrian model were made for the purpose of adopting more contemporary models from the same legal family, thus providing a higher degree of legal security in legal transactions. Some differences remained because of the adjustment of Croatian real property law to specific real property relationships resulting from the establishment of unity of ownership and the transformation of social into private ownership.

The choice of Austria as the model for the adjustment of the new Croatian real property regulation was the result of numerous considerations, aimed at guaranteeing that its adoption would positively contribute to real property reform.[52] To some extent, it was also an attempt to maintain some form of continuity in Croatian civil law, from the times when the ACC was applied as the basic civil law source in Croatia. This had left the ACC rules deeply rooted in the Croatian civil law system, and a fixed part of the legal tradition. In addition, other segments of the Croatian legal order important for the regulation of real property also had their roots in Austrian regulations. The land register system, civil proceedings, ex parte proceedings, enforcement proceedings and the service of notaries public, along with other services, were also developed under a strong Austrian influence. The rules of Austrian real property regulation contained numerous solutions, which, if adapted to the specific circumstances existing in Croatia, could form an effective basis for the new regulation of real property law, reinforcing Croatian private law and enhancing the development of a market economy, by drawing on existing experience in the application of the ACC provisions in case law and the significant amount of literature in this area.

How did the Austrian ACC impact the codification of real property law? In the RPA, the basic structure of real property as set forth in the ACC was preserved. The RPA, just like the ACC, does not separate property relationships involving chattels from those involving real estate, applying the same rules to both. The exemptions valid either for chattels or for real estate are specified. Ownership, co-ownership, common ownership and acquisition, protection and termination are provided for in the rules, following the tradition of the ACC. In fact, the new real property and land

---

[52] For further details on the preconditions that must be fulfilled in order for legal transplants to be able to contribute to the economic development of the country of adoption see Berkowitz, D., Pistor, K., Richard, J.F., Economic Development, legality, and the Transplant Effect, p. 2, 7 <www.cid.harvard.edu/cidwp/pdf/039-with%20tables.pdf>; Mistelis (*supra* note 15), p. 1068, 1069.

register regulations adopted many solutions from the ACC and other related Austrian regulations. The ownership of separate parts of real estate has also been provided for using the model of Austrian condominium ownership, including the solutions used in the Austrian Wohnungseigentumsgesetz of 1975. Using the ACC as a model, the RPA also preserved the acquisition of ownership and other real property rights resulting from legal transactions based on the principle of causal tradition. Apart from a valid legal transaction (a valid contract), any acquisition requires a corresponding mode of acquisition (traditio). The model of acquisition for real property rights over real estate not entered into the land register is acquired by the filing of a document with the court. Property rights are acquired by the delivery of a chattel into an individual acquirer's possession. Using the model of the ACC, Croatian law re-adopted the principle of superficies solo cedit for an acquisition resulting from building on another's plot, also adopting for exceptional circumstances the principle according to which the builder becomes the owner of the land. However, the rules for building on another's plot are supplemented by special rules for disregarding property boundaries pursuant to paras. 912 and 913 of the German Civil Code (BGB). The rules for acquisition by way of prescription were also adopted from the ACC, making prescribed deadlines much shorter.[53] The ACC rules regarding the types of claims of ownership have also been adopted into Croatian legislation. However, contrary to the ACC, the rule of exemption from the statute of limitations of real property claims is preserved (Article 161/1 of the RPA).

Other real property rights have also been regulated in accordance with the ACC. The provisions for neighbours' rights are mostly regulated using the same rights from the ACC as a model, but unlike those in the ACC, are grouped in a separate chapter of the RPA. With some minor interventions, servitudes are also provided for in accordance with the ACC rules. The ACC provisions for the typical, more common real servitudes, have also been kept, harmonised and extended in accordance with contemporary needs. Personal servitudes are traditionally modelled after the ACC (Article 199 of the RPA). Also, following the model of the Austrian Baurechtgesetz, which conceptually follows the ACC, meant that the right to build is provided for in the RPA (Article 280 of the RPA). The concept of a security right is likewise based on the ACC rules, but it has been modernised, developed and modified in order to better fulfil its function. It is particularly important to emphasise that in the RPA, the security right has an

[53] The Croatian real property order has preserved the situation as in the ACC in which there is no acquisition of ownership in favour of a registered person by way of acquisitive prescription through registration in the land register/Tabularersitzung (comp. Articles 159, 160 of the OA).

accessory nature, and that non-accessory security rights for property do not exist. Exemptions from this rule exist only in the rules for mortgages "up to the highest amount", and in the provisions taken over from Austrian law governing mortgage priority.[54] Most real encumbrances not expressly set out in the ACC are dealt with in accordance with the traditional construction used in Austrian practice, however, some solutions have been taken from German regulation on encumbrances.

The decisive impact of Austrian law is also reflected in the organization of the land register. The Croatian land register is organized exclusively on the model of the Austrian law governing the land register (Allgemeines Grundbuchgesetz, Grundbuchsumstellungsgesetz). In addition, the legal principles of the land register, its function and composition, different types of entries, their prerequisites, and the rules for establishing the land register and its computerisation have also been adopted from Austrian land register law. This structure was based on a number of factors: the Croatian land register was established in 1855 and has always operated under influence of Austrian law. The decision to preserve continuity in modernising the legislation in accordance with the demands of contemporary legal transactions involving real estate, it therefore made sense for the new legal structure of the land register to be based on the Austrian model.

However, although the RPA and the law governing the land register are mostly based on the ACC tradition, some solutions were borrowed from various legal systems in Central Europe which were considered to be more modern and better suited to the contemporary market economy. In contrast to the ACC, the RPA lays down a modern concept of possession. Namely, the RPA has preserved the objective concept of possession introduced as early as 1980 when the former Act on Ownership Relationships was adopted from German real property legislation. Based on the model of German law (§§ 855−872 BGB), all legal concepts concerning possession are defined (direct and indirect possession/unmittelbarer und mittelbarer Besitz, independent possession/Eigenbesitz, underpossessor/Besitzdiener, acquisition of possession). In addition, the protection of the bona fide purchaser in legal transactions involving chattels was modelled on German law. The RPA also adopted the BGB provisions on acquiring chattels from non-owners (§ 932 BGB).[55] However, the Croatian legislature decided not to increase the level of protection of good faith for real estate transactions as done under German law. The RPA preserved the Austrian system of "a

[54] For further details on the legal effects of the principle of accessoriness on mortgages see Josipović, Länderbericht – Kroatien (*supra* note 46), p. 179−188.

[55] When compared to the rules on the acquisition of chattels from non-owners referred to in para. 367 of the ABGB adopted to the former ABOR Act, these rules offer a much higher level of protection of trust in the legal transactions involving chattels.

moderate protection of good faith", according to which an action for cancelling a recorded interest can be brought against even an honest acquirer within certain time limits. There is still a rule which permits an extension of the protection of good faith with regards to the authenticity of the land register, until the expiration of the time limit within which an action cancelling a recorded interest (Löschungsklage) can be brought against an honest acquirer (not later than 3 years from an invalid registration). However, in contrast to the Austrian model, all rules regarding the protection of good faith in the land register are expressly provided, not only in the Land Register Act, but also in the RPA provisions governing real property rights. Namely, the RPA expressly provides for the protection of good faith in the authenticity and completeness of the land register entries, the preconditions for protection, time limits for cancellations, and the protection of good faith for cases of multiple alienation of the same real property.[56]

4. Development of Real Property Law upon the Adoption of the RPA (Post-Codification Phase)

a) General Observations

At the beginning of its application, the RPA provided a consistent system of real property regulation. Numerous legal transplants from Austrian and German laws, and solutions that resulted from previous Croatian real property regulation, were successfully integrated into a single body of law. The RPA contained a complete system of norms for general real property regulation based on principles of respect for private ownership, party autonomy and entrepreneurial freedom.

However, changes in the regulation of real property did not end after the RPA entered into force, when a number of "lively" legislative activities began. A series of new regulations was adopted governing individual areas of property law. The justifications for these activities were many: to secure more protection for various objects (particularly real estate), to increase the protection of creditors when establishing and realising their security interests and to harmonise Croatian real property legislation with the acquis communautaire. All these activities contributed to the general disintegration of real property regulation in the RPA, and eventually to its fragmentation. The outcome of these changes is that in general, real property regulation is marginalised, since many RPA provisions can no longer be applied due to new provisions in separate laws which have taken precedence over the RPA.

---

[56] Comp. Article 8 of the LRA and Articles 122−125 et al. of the OA.

b) Separate Legal Regimes for Different Property and Goods

In Article 52, the Constitution of the Republic of Croatia lays down the following:

"The sea, seashore and islands, waters, air space, mineral wealth and other natural resources, as well as land, forests, fauna and flora, other parts of nature, real estate and goods of special cultural, historic, economic or ecological significance which are specified by law to be of interest to the Republic of Croatia, shall enjoy its special protection.

The way in which goods of interest to the Republic may be used and exploited by holders of rights to them and by their owners and compensation for the restrictions imposed on them, shall be regulated by law."

On the basis of Article 52, and in order to provide special protection, many separate laws were passed providing for separate ownership regimes for various kinds of property and for real estate in particular. There is a trend whereby separate laws are adopted, on the basis of Article 52 of the Constitution, through which an increasing number of property types are proclaimed to be goods of interest to the Republic of Croatia so that they are protected by a separate (public law) regime.

These laws in turn, provide separate legal regimes for a range of property, including maritime goods, islands, waters, forests, cultural goods, agricultural land, and public roads.[57] These are mostly regulations containing a number of mandatory rules which take precedence over the private ordering of real property relationships in the RPA. All of these regulations contain a series of public law restrictions by which owners are limited in the possession, use and legal disposal of property. Many such restrictions are justified and necessary for the protection of goods of interest to the Republic of Croatia.[58] However, there are many public law restrictions which are disproportionate to the goals they were intended to achieve. Frequently, owners are unnecessarily limited in their rights to dispose of their property and goods. For example, valid disposal of certain ownership rights is regulated differently in different regulations, often conditioned by preliminary administrative permits.[59] In some cases, the rights of owners to

---

[57] Comp. the Forest Act (Official Gazette NN 140/05, 82/06, 129/08, 80/10), the Agricultural Land Act (NN 152/08, 21/10), Public Roads Act (NN, 180/04, 138/06, 146/08, 38/09, 124/09, 153/09, 73/10), the Nature Protection Act (NN 70/05, 139/08), the Protection and Preservation of Cultural Goods Act (NN 69/99, 151/03, 157/03, 87/09, 88/2010), the Islands Act (NN 34/99, 149/99, 32/02, 33/06), the Maritime Domain and Seaports Act (NN 158/03, 141/06, 38/09) et al.

[58] Accordingly, Article 50/2 of the Constitution expressly provides that the exercise of entrepreneurial freedom and property rights may exceptionally be restricted by law for the purposes of protecting the interests and security of the Republic of Croatia, nature, the environment and public health.

[59] For example, there are separate rules prohibiting the parcelling of land without a special permit obtained by a competent body (Article 119 et al of the Physical Planning

dispose of real estate can only be exercised with the participation of different administrative bodies.[60] These restrictions on real property relationships often narrow and even eliminate the possibility of applying market and entrepreneurial freedoms and private autonomy in property legislation that is typical for a free market economy. Whenever a separate regulation provides for a special ownership regime governing a particular thing or good, the RPA is applied only when a separate law or act does not provide differently. In a large number of cases, the application of general real property regulation is reduced to a minimum, or is neutralised.

c) New Secured Transactions

The reform of secured transactions did not end with the detailed regulation of security rights in the RPA. In order to increase the protection of mortgagees and enable a faster settlement of their claims, the area of security interests has continued to develop at a high speed. In addition to the security rights provided for in the RPA, many new laws have been passed which provide for various new types of rights, including some completely new security rights.

The Enforcement Act (EA) introduces some new forms of security established on the basis of a security agreement made in the form of a public document (court record/a notarial act).[61] The advantage of this approach, when compared to the "classic" type, is that the payment of secured interest can immediately be requested at the moment of maturity, thus significantly shortening the payment procedure. The EA has introduced a special type of security – a fiduciary transfer of ownership (corresponding to the German Sicherungsübereignung) that provides more protection for a creditor, by significantly deviating from the principles on which the general, traditional regulation of a security right is based.[62]

The most significant changes in the system of proprietary security were introduced by laws that provide for special registers into which real prop-

---

and Construction Act, Official Gazette NN 76/07, 38/09) and Article 78 of the Act on Agricultural Land).

[60] For example, the new Agricultural Land Act of 2008 expressly provides that private owners of agricultural land cannot independently alienate their agricultural land, but must do so through a special state agency which will invite tenders for its sale (Article 81 et al). If they fail to do so, their disposal of the land will be void.

[61] Comp. Article 261 et al of the Enforcement Act.

[62] For example, the principle of judicial enforcement according to which the settlement proceedings were conducted by the court has been abandoned. In the case of fiduciary transfer of ownership, the settlement proceedings are conducted by notaries public. If the sale does not succeed, the creditor becomes the owner of the disputed property. Thereby, the creditor is not obliged to return to the debtor the difference in the value of the property which exceeds the value of the secured claim (Article 277 of the EA).

erty security interest on chattels and rights must be entered. In this way, a registered pledge over chattels and rights was gradually introduced in the Croatian legal order. For example, the Capital Markets Act[63] provides for a pledge on dematerialised securities. A pledge is established by entering the right in the dematerialised securities account kept by a special agency (the Central Depository Agency)[64], and a claim secured by a pledge is enforced in an out-of-court process (Article 495). The Act on the Register of Security Rights in Chattels and Rights before a Court or a Notary Public/ Register Act of 2005[65] provides for a registered pledge, or a registered fiduciary transfer of ownership as a security right on all chattels and rights that may be subject to legal transactions (including shares, stocks, and business shares in companies). A creditor acquires a security interest only upon its registration in the special Register maintained by the Financial Agency (FINA).[66] A new introduction to Croatian law, under the Register Act, is that all assets in a particular location may also serve as the object of a registered pledge ("floating charge").[67] In this case, the principle of specificity is maintained by determining the location (business premises, warehouses, etc.) where all the assets that are the object of a pledge are located. In that regard, Croatian law has significantly departed from models belonging to the German legal tradition, which still do not recognise a registered pledge over chattels and rights. This legal regulation of registered pledges is almost entirely the result of the autonomous development of the relevant Croatian regulation.

The new regulations on proprietary security have therefore significantly departed from the concept on which the RPA based its regulation of security interests. Many of these new elements may be considered as a positive shift in the modernisation of secured transactions (e.g. the introduction of a registered pledge, extrajudicial enforcement of secured claims). This, however, requires the re-establishment of a legally consistent system of secured transactions. The current system is distorted as a result of the existence of a number of separate regulations, which provide for these transactions in different ways, and to different degrees. Moreover, they contain many loopholes which prevent the RPA general rules from being applied, thus explaining why their application results in various interpretations.

---

[63] Official Gazette NN 88/08, 146/08, 74/09.

[64] For more on this see <www.sda.hr>.

[65] Official Gazette NN 121/05.

[66] For more on this see <http://zaloznaprava.fina.hr/>.

[67] Article 38 of the Register Act.

d) Europeanisation of Property Law

The development of property law in the post-codification phase is also determined by the europeanisation process of the entire Croatian legal order, including its private law. As was the case in other Member States of the EU, the European acquis communautaire has had a relatively limited impact on the development of Croatian property law. Croatia's harmonisation with the acquis communautaire is mostly being carried out by adopting separate laws to implement European directives. Thus, the Financial Security Act[68] has been in force since 1 January 2008, which fully incorporated the Directive on Financial Collateral Arrangements[69]. The Obligations Act has implemented the Late Payment Directive[70], which, among other things, provides for the retention of title as the seller's security against late payment.[71,72] The Consumer Protection Act implemented the Timeshare Directive[73] which provides that a timeshare may be entered into the land register, thus protecting its acquirer from third persons.[74] The Protection and Preservation of Cultural Heritage Act implemented the Directive on the Return of Cultural Objects Unlawfully Removed from the Territory of a Member State,[75] with the conflict of laws rule from this Directive incorporated into Article 12 of the Act, which transfers ownership of the cultural object to the Member State requesting it on its return.[76]

An extremely important process in Croatia's harmonisation with the *acquis communautaire* was the passing of amendments to the RPA,[77] which provided the preconditions for a foreigner to acquire real estate in Croatia. Within the framework of fulfilling the obligations referred to in Article 60 of the Stabilisation and Association Agreement between the European Communities and its Member States and the Republic of Croatia

---

[68] Official Gazette NN 76/07.

[69] Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangement (OJL 2002, 168, p. 43).

[70] Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000 on combating late payment in commercial transactions (OJ L 2000, 35, p. 35).

[71] See Article 462 et al of the OA.

[72] Retention of Title (ownership) was previously expressly provided for in the RPA. Pursuant to Article 32/5, retention of title may be agreed upon to secure any claim regardless of the legal relationship.

[73] Directive 94/47/EC of the European parliament and the Council of 26 October 1994 on the protection of purchasers in respect of certain aspect of contracts relating to the purchase of the right to use immovable properties on a timeshare basis (OJL 1994, 280, p. 83).

[74] Comp. Article 88 of the Consumer Protection Act.

[75] Council Directive 93/7/EEC of 15 March 1993 on the return of cultural objects unlawfully removed from the territory of a Member State (OJL 1993, 74, p. 74.).

[76] Comp. Article 88 of the Protection and Preservation of Cultural Heritage Act.

[77] Official Gazette NN 146/98.

on Behalf of the European Community,[78] Croatia had to liberalise the acquisition of real estate by nationals of Member States in accordance with the principle of free movement of capital in the European Union (Article 56 of the Treaty Establishing the European Community). On 1 February 2009, amendments to the RPA[79] entered into force, which rendered the provisions of the RPA inapplicable effectively removing the special preconditions for foreign nationals to acquire real estate for nationals and legal entities from member States of the European Union.[80] EU nationals and legal entities can now acquire ownership of real estate under the same conditions as nationals of the Republic of Croatia or legal entities based in Croatia. Certain areas have been exempted, as listed in Annex VII (Natural Resources and Agricultural Land) of the Stabilisation and Association Agreement on the Acquisition of Real Estate in Croatia by nationals of Member States of the European Union. In short, since 1 February 2009, there are no discriminatory restrictions on cross-border movement of capital for EU nationals investing in real estate in Croatia.

The harmonisation of Croatian real property law with the European *acquis communautaire* has led to its even greater fragmentation. In the harmonisation process, the Croatian legislature applied a method by which the content of directives was almost literally transposed into separate laws, or was carried out by way of amending existing regulations. As a rule, there is no legislative intervention in positive regulations whose area of application overlaps with the area of application of a particular directive. However, this should be done in order to preserve the integrity of the legal system whenever new concepts are incorporated into the national legal system. In the process of implementing directives, the systemic adjustment of other areas of private law has not yet taken place. Such an adjustment is necessary since European private law is very fragmented, and its implementation requires a systematic reform of the entire body of private law. This is a very complex task even for the well-established private law orders of Member States, let alone for private law orders which are quite new as in Croatia. This clarifies why regulations that implement directives have their own "legal life" detached from all other national norms. In practice, there is often no corresponding legal infrastructure in national legislation to apply these directives in the most efficient way. This is par-

---

[78] The English version can be found at <http://narodne-novine.nn.hr/clanci/medunarodni/328068.html>.

[79] Official Gazette NN 146/08.

[80] Comp. Article 358a of the RPA which expressly provides that the provisions of Articles 354−358 of the RPA setting forth special preconditions for the acquisition of real estate in the Republic of Croatia do not apply to nationals and legal persons of the European Union.

ticularly the case when, via directives, some legal concepts are introduced into the Croatian national system which do not originate from continental European legal orders. There are similar examples in the area of real property law as well. For example, the Financial Security Act, in accordance with the Directive on Financial Collateral Arrangements, introduces new forms of security in financial instruments (company shares, other securities equivalent to company shares, bonds and other forms of debt instruments). Their specific legal regulation in the Directive, means that general rules of property, enforcement and bankruptcy law are not applied to these types of security interest. Their regulation largely deviates from the fundamental principles on which the general regulation of real property security interest is based in Croatian law (such as the principle of enforceability, specificity, and causal tradition). Therefore, the general rules on real property security interests cannot be applied to these new types of security interests. Another example is the implementation of the Timeshare Directive. In the Consumer Protection Act, all provisions governing the protection of consumers in timeshare contracts were properly implemented. However, Croatian legislation does provide detailed regulation for timeshares as a separate right to a temporally limited use of real estate. It has therefore remained an open issue in Croatian law as to how other aspects of this legal relationship concerning real estate should be regulated, excluding those of a timeshare contract provided for in the Consumer Protection Act in accordance with the Directive. In particular, the legal nature of this particular type of legal relationship remains an open issue.

IV. Concluding Remarks

Current Croatian private law regulation, and thus its property component, constitutes a specific "composition" in the normative sense, composed of three groups of elements. The first group consists of legal transplants mostly borrowed from continental European legal orders under the German tradition. The second group consists of legal concepts which are a result of the autonomous development of Croatian private law as part of the transition from socialist to free market regime. The third group consists of diverse legal instruments introduced into Croatian legislation in the process of harmonisation with the acquis communautaire. Each group of elements has a special function in the order of Croatian private law. Legal transplants constitute the basis for the development of entrepreneurship, competition and private ownership, and are founded on the principle of private autonomy and freedom of contract. The legal institutions resulting from the autonomous development of Croatian private law have played a

very important role in the transition process from social to private ownership regulation. Finally, elements borrowed from European law contributed to eliminating discrimination in private law relationships, eliminating possible restrictions to the free movement of goods, services and capital and promoted market competition. However, they can only constitute an appropriate legal structure for the development of a market economy if they are combined to create a harmonious whole of a "sound legal system". On the other hand, successful application in practice (particularly in the form of legal transplants) largely depends on how they are incorporated into the legal and economic system, and the level of adaptation to local circumstances and needs, and whether there are corresponding instruments to enable their successful application.[81,82] It seems, however, that at this point in time, all these elements do not exist and cannot fulfil their function in the legal order.

For now, the application of legal transplants in the area of property law in practice is not as pervasive as should be the case. The legal institutions borrowed from foreign legal orders and aimed at modernising the regulation of Croatian real property, as well as adjusting it to the needs of a modern market economy, are often not in use. As a rule, these are sophisticated legal institutions whose application requires not only extensive legal knowledge and experience, but also a highly sophisticated economic and judicial infrastructure, a developed market and the corresponding information technology basis. Legal transplants are usually borrowed from legal systems in which these preconditions (necessary for their successful application) have already been fulfilled. In their parent legal orders, these developed simultaneously with the entire legal and economic infrastructures necessary for their application. Unfortunately, these preconditions have not always been fulfilled in the Croatian legal and economic systems. Some legal transplants were adopted in property law, but their adoption was not accompanied by corresponding adjustments of other areas of the law. Moreover, in many cases, the market has not been at the level of development that would require the application of such highly developed legal instruments. The efficient application of legal transplants is often not possible because a number of the important legal instruments that are necessary for their application do not function in practice. For example, sophisticated rules adopted from Austrian law on the disposal of the pri-

---

[81] See Berkowitz et al. (*supra* note 52), p. 6, 9 i dr.

[82] An answer to this question often depends on the assessment of whether the adopted model corresponds to the specific features of the national market economy. This is a particularly important issue for post-socialist countries where the adoption of foreign models should be preceded by a detailed economic and comparative analysis of their bodies of law. For more on this see Ajani (*supra* note 24), p. 116.

ority rank of a mortgage are not applied in practice.[83] To some extent, these rules modify the strict rule that Croatia also adopted from Austrian law on the accessoriness of a mortgage. These rules are frequently used in practice by Austrian banks made possible by their efficient computerised land register system, which virtually eliminates problems concerning the protection of trust, in a real estate market that is more developed than that of Croatia. Although Austrian rules governing the priority of a mortgage[84] have been adopted almost word for word, they are almost never used in practice. Croatian banks have not shown any interest in the application of transplanted models of priority rank of mortgage disposal, mainly due to the fact that the Croatian land register system is underdeveloped, dated and inefficient. Although the Austrian model of a computerised land register has been adopted in the Croatian land register law, this computerisation was based on the fact that the Austrian land register, although previously kept by hand, was continuously updated and it was only a matter of a technical conversion of the current land register data. This was not the case in Croatia, where the process of computerising the Croatian land register also needed to include the process of updating its data. This has a significant impact not only on the process of computerisation, but also on the time it takes to implement.[85] Moreover, problems with the application of legal transplants are most often caused by insufficient education and inadequate understanding of individual institutions both by practising lawyers and judges. In practice, legal concepts are still interpreted under the predominant influence of court practice developed at the time when old real property rules applied.

A special problem in the application of legal transplants is the significant impact of public law on real property regulation. In the Croatian legal order, an optimal relationship between private law and public law norms in the regulation of real property relationships has yet to be established. The application of a number of legal transplants is often blocked by many public law regulations that limit their application, or condition them with the fulfilment of various public law preconditions. As one of many examples, the legislature has borrowed rules on the establishment of condominiums from Austrian law. In Austrian law, these rules are solely based on the private autonomy of co-owners. In Croatian law, however, the establishment of a condominium is possible only if the competent administrative authori-

---

[83] For more on this see Josipović, Länderbericht – Kroatien (*supra* note 46), p. 185, 186.

[84] Comp. Articles 347, 348 of the RPA.

[85] Currently, a project called Uredjena zemlja (Organized Land) in the Republic of Croatia is aimed at updating and computerising the land register and cadastre as part of a joint information system. For further details on this project at <www.uredjenazemlja.hr>.

ties have issued a special administrative permit to use the building, regardless of whether consent has been expressed by all co-owners. Buildings can only be entered into the cadastre and land register with this permit. In some areas important for the development of tourism, a special law prohibits condominium ownership in some buildings.

Finally, there is also a problem with the interpretation of legal transplants, in particular, with the process of monitoring their further development within the legal order from which they were adopted. It would be logical that the development of legal transplants is monitored and compared with their development in their parent legislations. However, this is not the case. It seems that once they become an integral part of domestic law, the content of the law remains the same as when it was first adopted and does not subsequently develop. In their parent legislation, however, they undergo constant changes and modernisation. For example, Croatian real property regulation borrowed the Austrian provisions on condominiums (Wohnungseigentumsgesetz) of 1975. A new regulation for condominiums has since been adopted in Austria (Wohnungseigentumsgesetz/2002) based on the same principles as the one of 1975, but considerably modernised to enable more efficient management of real estate and better operation.[86] However, in Croatian real property regulation, the rules of the Austrian Act of 1975 are still valid and there is no interest in modernising these rules in accordance with the new Austrian model.

The introduction of legal transplants into Croatian real property law was necessary for the modernization of this area of private law and its reintegration into the circle of continental European legal orders to which it once belonged.[87] The legislature opted for an approach which did not constitute full reception of foreign bodies of law, but rather introduced only some foreign legal institutions and included them in already existing real property institutions which had developed autonomously in Croatian law. However, in order for legal transplants to survive in practice and to be applied with the same effect as those in their parent legislations, it is necessary to develop a corresponding legal, judicial, economic and information structure. This is a more serious, more difficult and significantly longer process than pure codification. It requires substantial efforts by all who are participating in the process of reforming Croatia's legal order.

---

[86] For more on this see Kolmasch, W.: Das neue Wohnungseigentumsgesetz (WEG 2002), Wien 2002, p. 3, 4, 43−68; Prader, Ch., Wohnungseigentumsgesetz, Wien 2002.

[87] On legal borrowing (legal transplants) as a major factor in the process of legal change and development see Watson, A.: Legal Transplants and European Private law in The Contribution of Mixed Legal Systems to European Private Law (ed. J. Smits), Antwerp 2001, p. 9.

Property Law in Bosnia and Herzegovina

MELIHA POVLAKIĆ

I. Introduction

In Bosnia and Herzegovina (BiH), as in most other transitional countries private law was marginalized during the decades of socialism. The legal order in the former Socialistic Federative Republic Yugoslavia (SFRY) and BiH was characterized by a dichotomy between state and private ownership. Although the former played a dominant role and was better protected, private ownership had also existed alongside it. Private ownership had never been abolished; however, for some important assets, particularly for real estate, it was greatly restricted.[1] Legal relations between private persons involving private property, to the extent the right existed, were subject to a traditional private legal regime with classic private law institutes. This marginalization mirrors in the remote practical importance

[1] More about this may be found in Nikola Gavella, Novo hrvatsko stvarno pravo u funkciji prilagodbe pravnog poretka Republike Hrvatske europskome, in: Das Budapester Symposium, Beiträge zur Reform des Sachenrechtes in den Staaten Südosteuropas/ Budimpeštanski simpozijum, Doprinos reformi stvarnog prava u državama jugoistočne Evrope, Gesellschaft für Technische Zusammenarbeit mbH (ed.), Bremen, 2003, 21.

of some institutes (e.g. collateral law), which were for this reason scarcely regulated. For instance, property law was regulated by only ninety legal provisions, only seven of which concerned the hypothec. Such limited legislation is not appropriate for the major role private law should have in a market based economy and in a transformed social order.

In 1992, BiH declared its independence and separation from former SFRY, which led to the aggression and the highly destructive war ended in 1995 by the signing of the Dayton Peace Agreement. The Annex 4 to this Peace Agreement represents the Constitution of the State of BiH.

BiH separated from former Yugoslavia during the phase of crucial reforms of the socialist economy, socialist legal system, as well as the property order. The Amendments to the Constitution of the SFRY (1988)[2] and to the Constitution of the Socialistic Republic of BiH (1989 and 1990)[3] represented the mainstream measure of property order reform – the guarantee of property was established, the restrictions of private property were abrogated and all types of property rights (private and public property) were declared equal. During the war (1992–1995) this reform process was interrupted or slowed down, and still, more than ten years after the war ended, property law reforms have not yet been completed; BiH remains in a never-ending transformation process. The rules regulating restitution have not yet been adopted,[4] and privatization is very slow and burdened with significant problems (unclear property relations, the annulations of certain privatization transfers resulting from frequent abuses).

The reform process in each former socialist country is necessarily a time-consuming process involving several relevant factors (level of economic development, political structure, political influences, level of knowledge and education of the lawyers at the court and administration, culture and mentality). In addition in BiH, there are still unresolved political conflicts, reflecting the complex, expensive and inefficient organization of the state as established by Annex 4 to the Dayton Peace Agreement. BiH is a

---

[2] Amendments IX-XLII to the Constitution of the SFRJ [*Amandmani IX–XLII na Ustav Socijalističke Federativne Republike Jugoslavije*] (Službeni list SFRJ 70/88 i 57/89).

[3] Amendments XX-LVIII to the Constitution of the BiH [*Amandmani XX-LVIII na Ustav Socijalističke Republike Bosne i Hercegovine*] (Službeni list SR B[iH 13/89), as well as Amendments LIX-LXXX to the Constitution of the BiH [*Amandmani LIX-LXXX na Ustav SR BiH*] (Službeni list SR BiH 21/90).

[4] From the economic point of view, the restitution is not crucial, but clarified and settled ownership relations. The identity of an owner is not as important as the fact that someone actually is the owner. In this sense, Ferenc Madl, Restoration of Property in the Central and Eastern European Countries, Festschrift für Ulrich Drobnig zum siebzigsten Geburtstag, Tübingen, 1998, 598. However, ownership relations in BiH are still not clear and settled.

complexly organized state divided into two entities and one District: Federation BiH (FBiH) and Republic Sprska (RS) and the Brčko District BiH (BD BiH). Legislative competences are divided between the State and its parts. The Constitution provides for the presumption of competence in favour of the entities; the competences of the State BiH are explicitly stated. The Constitution of BiH places the responsibility for the regulation of property law on the entities and the BD BiH. Furthermore, the Federation BiH is divided in ten cantons which also have some legislative competences in the field of property law (e.g. the cantons are responsible for regulating some issues related to the ownership of freehold apartments or flats). This amounts to fourteen legislators (state BiH, two entities, BD BiH, ten cantons) in a small country with only 4 million inhabitants.

In the transition process, in BiH as well as in other transitional countries, the necessity of finding new legal solutions in the area of private law was enormous and it was often satisfied by solutions borrowed from other legal orders. The circulation of legal models is a process that is common in all transitional countries departing from the socialist model of law and economy, stems predominantly from two factors. One is, beyond any doubt, a need to find fast, instant solutions for various matters in the transformation process, which is, in some opinions, "one of the greatest challenges of the end of the twentieth and the beginning of the twenty-first century".[5] In developed western countries, the solutions were developed both by the legislator and by doctrine and case law over a longer period of time. Countries in transition have neither the time nor the need to go along the same path of development; the transfer of law from West to East is a reasonable solution.[6] In this respect, transitional countries have an advantage because they can choose a ready-made model "on the market", i.e. the solution that suits them best; but on the other hand, this freedom of choice may also become a trap. The freedom of choice should be conditioned by the specific needs and situations of each individual country. However, this freedom is often more restricted by another factor. This leads us to the second reason for reception – the decision which solution to choose is

---

[5] Petar Šarčević, Legal Reforms in Countries in Transition, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, Supplement 3, (2003), 759–769. According to some, after the collapse of the USSR and socialism, the changes that have taken place were so profound that they had no parallel in history. See, for instance, Lado Chanturia, Recht und Transformation, Rechtliche Zusammenarbeit aus der Sicht eines rezipierenden Landes, RabelsZ, 72 (2008), 115.

[6] About this in Šarćević (previous note), 761, Gianmaria Ajani, Transfer of Legal Systems From the Point of View of the "Export Countries", in: Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten, ed. by Ulrich Drobnig et al., 1998, 37 et seq., Gianmaria Ajani, La circulation des modèles juridiques dans le droit post-socialiste, R.I.D.C. 4/1994, 1088–1105.

often determined by prestige or even pressure by the "donor" country or organization.[7] Therefore in some cases, one can even talk about imposed reception (if imposed reception can be called 'reception' at all).

The process of reception is evident, to a smaller or larger extent, in all transitional countries, therefore, even before starting to investigate the case of BiH, it should be noted *a priori* that completely autonomous development of law is impossible in a transitional country. The question arises whether an autonomous development would be feasible or even desirable in today's globalized world, characterized by strong internationalization of legal relationships facilitated by technical progress, communication capabilities, increased mobility, creation of internal regional markets[8] and the activities of supra-national institutions, with the task of unifying law in general. It is hardly possible for the national law of any country to develop in complete independence. Legal doctrine speaks about the denationalization of private law,[9] the integration of private law,[10] or the necessity for reconstruction of legal dogmatics which, in the globalized world, can be no longer limited to national frameworks.[11] Transitional countries may not be left out of that process providing an additional reason for the transfer of legal structures from other legal orders or supra-national law.

The transfer of laws may have one more cause. A large number of transitional countries have walked the whole length of the path from signing the Stabilization and Association Agreement to full membership of the European Union. BiH has signed the said Agreement; however, before BiH became obliged to take over the "*Acquis communautaire*," it had already voluntarily harmonized some areas of private law.[12] The process of harmonization with the European legal order also represents a form of transfer of law.[13]

This paper will provide introductory remarks on main characteristics of the ownership order and property law in BiH. This will be supplemented

---

[7] Ajani, Transfer of Legal Systems From the Point of View of the "Export Countries", 48–49, Gerhard M. Rehm, Rechtstransplantate als Instrument der Rechtsreform und -transformation, RabelsZ 72 (2008), 5, Chanturia (*supra* note 5), 118–119.

[8] Eva-Maria Kieninger, Einführung in das Thema, in: Denationalisierung des Privatrechts, Symposium anlässlich des 70. Geburtstages von Karl Kreuzer, ed. by Eva-Maria Kieninger, Tübingen, 2005, XI.

[9] Kieninger (previous note), XVI.

[10] Karl Kreuzer, Schlussworte, in: Denationalisierung des Privatrechts (previous note), 69.

[11] Mark van Hoecke, L'harmonisation du droit privé en Europe, Revue européenne de droit de la consommation, 2/2003, 108.

[12] For example consumer protection law and competition law.

[13] Norbert Horn, Handelsrecht und Recht der Kreditsicherheiten in Osteuropa, Berlin, New York, 1997, 108, Berndt Schlemann/Arsèn Verny, Die Harmonisierung des Rechts der Tschechischen Republik im Rahmen des Assozierungsprozesses, WiRO, 1996, 89.

by a general overview of the recent legal reforms and positive legal framework of the property law and collateral law, i.e. secured transactions law. However, this paper does not aim to give an extensive analysis of the relevant institutions, but a presentation of the methods of legal transfer. In order to understand the current situation in the area of property law, it is necessary to make a short historical review (II), but only to the extent necessary to provide the basic information on legal tradition in BiH, as well as to understand the problems BiH is encountering in the process of transformation and to compare the reception process that took place in the past in BiH with the recent one.

Using a number of selected examples in the area of property law and collateral law it will be shown how the reform of certain legal institutions has developed and how solutions from foreign legal systems have replaced the old, how they fit into the legal order and how harmonious they are with the changes of other legal institutions of different provenience (III.). The most remarkable examples, collateral law over movable property (IV.1) and collateral law on real estate (IV.3) were selected for research. This was done for the following reasons: both property and collateral law should be, in addition to some other branches of private law, the priority for reform in the transition process.[14] Furthermore, collateral law is a paradigmatic example of different influences within the reform process. Secured transaction law over movable and immovable property sharply differ. Securities over movable property are regulated by the Framework Law on Registered Pledges/*Okvirni zakon o zalozima* (OZZ)[15] enacted at the state level in 2002, which was highly influenced by the US-American Uniform Commercial Code. USAID supported this reform and the drafting of the entire law with only limited consultations with national legal experts. Collateral law over movable property represents the reception of institutions from the Anglo-American legal system and the transfer of legal institutions and principles from a completely different legal culture; raising the question of convergence for the two different legal cultures. The substantive law on hypothec is influenced by Austrian law, whereas some closely related procedural provisions were exposed to completely different influences. The new institution of land charges will be introduced in collateral law over real property alongside the classic hypothec. The hypothec will be regulated on the basis of the Austrian model, while land charges will be adopted from the German legal system. However, this transfer is of spe-

---

[14] Ajani, La circulation des modèles juridiques dans le droit post-socialiste, 1096, Lajos Vekas, Privatrechtsreform in einem Transformationsland in: Aufbruch nach Europa, 75 Jahre Max-Planck-Institut für ausländisches und internationales Privatrecht, ed. by Jürgen Basedow et al., Tübingen, 2002, 1049 et seq.

[15] Službeni glasnik BiH 28/2004.

cific nature, because it represents the transfer of German judicial and bank practices rather than the transfer of the statutory provisions of the German Civil Code (BGB).[16]

II. Short Overview of the Historic Development of Civil Law in BiH

BiH was a part of the continental European legal circle as part of the former Kingdom of Yugoslavia, until the World War II and the socialist revolution. Private law and procedural law were highly influenced by Austrian law, arguing for the perception that the modern development of private law in Bosnia and Herzegovina is a history of influences from the Austrian Civil Code (ABGB) and Austrian private law which took place in three stages – direct implementation of the ABGB from 1878 until the end of the World War I, the influence of Austrian law on the regulations adopted in the Kingdom of Yugoslavia between the two world wars, and implementation of the *legal rules* from the ABGB and the laws of the Kingdom of Yugoslavia that were influenced by Austrian law in the socialist Yugoslavia for decades after the World War II.

From 1878 till 1918, BiH was a part of the Austro-Hungarian Monarchy. By the decision of the Berlin Congress, governance over Bosnia and Herzegovina was transferred to the Austro-Hungarian Monarchy. In accordance with the decisions of the Berlin Congress, even after governance had been transferred to the Austro-Hungarian Monarchy, application of the laws in force at that time in BiH should have been continued.[17] However, the judges educated in the Monarchy did not know the Turkish language or Turkish legal sources, so the implementation of the ABGB started *via facti*,[18] and its impacts on the BiH legal order are still fundamental.

---

[16] Classic scholars of the legal transfer doctrine speaking about reception did not originally include the reception of court practice but only the reception of the statutory law. See under Rehm (*supra* note 7), 6 and footnote 25.

[17] Article XXV of the Berlin Peace Agreement transferred the mandate to govern BiH to the Austro-Hungarian Monarchy; however, BiH remained under sovereignty of the Sultan. More by Dženana Čaušević, Pravno politički razvitak BiH, Sarajevo, 2005, 195.

[18] At the same time, there were judges who were educated in the Ottoman Empire. To the same extent as the national structure and education of judges was heterogenic, the implementation of law was an equally heterogenic one. There is a saying that the first instance judges ruled in accordance with reason, the second instance judged in accordance with ABGB, while the supreme instance judges ruled in accordance with the *Medjele* (The statute regulating the private law in the Ottoman Empire – author's note). So Fikret Karčić, Moderne pravne kodifikacije, Predavanja i zbirka tekstova, Sarajevo, 2006, 98.

Following the dissolution of the Austro-Hungarian Monarchy, the Kingdom of Serbs, Croats and Slovenians, later called Kingdom of Yugoslavia was established in 1918, unifying the different countries, each with its own history, and affiliation to different legal systems. BiH was one of the six different legal areas within the Kingdom of Yugoslavia. Civil law was never codified in the Kingdom of Yugoslavia[19] and during its existence, civil law in BiH was regulated by the ABGB. For citizens of Muslim religion, sharia law remained in force in family and succession matters.

The influence of Austrian Law was not limited to the application of the ABGB. During this period, in the Kingdom of Yugoslavia some important laws were adopted under the strong influence of other Austrian laws. Important for the purposes of this paper, three land registry laws were adopted in 1930 and 1931 regulating the establishment and organization of land registries as well as the procedure of registration. They represented an adoption of solutions from the Austrian land registry law with the task of implementing them in the whole Kingdom of Yugoslavia;[20] this regulation, however, had been in force in BiH since the end of 19th century, when the first cadastre survey of BiH was conducted and land registries of the Austrian/German type were established. After the adoption of these three laws in 1930/31, the land registries in BiH established by the Austro-Hungarian Monarchy continued to be maintained in line with the new (although essentially, the same) laws.

The influences of the ABGB or Austrian laws did not stop with the socialist revolution. The Law on Termination of Validity of the Regulations coming into force before 6 April 1941 and during the Occupation,[21] interrupted the continuity of the legal order between the socialist Yugoslavia and Kingdom of Yugoslavia.[22] The regulations that had been in force in the Kingdom of Yugoslavia by 6 April 1941 went out of force, and regulations enacted during the occupation were declared null and void.

---

[19] The work on drafting the new civil code for the Kingdom of Yugoslavia started in 1919. The ABGB was used as a model. The work resulted in the Draft Civil Code of Yugoslavia from 1929. This Draft was criticized because it had been based on the oldest civil code in Europe, which was, additionally, perceived as foreign to the national spirit. Božidar S. Marković, Reforma našeg građanskog zakonodavstva, Beograd, 1939, 28–30.

[20] Law on Land Register [*Zakon o zemljišnim knjigama*/*Grundbuchgesetz*], Law on Organization, Establishment and Replacement of the Land Registers [*Zakon o unutrašnjoj organizaciji, osnivanju i izmjeni zemljišnih knjiga*/*Gesetz über innere Organisation, Anlegung und Austausch von Grundbüchern*] (1930), and Law on Land Register's divisions, Separations and Attributions [*Zakon o zemljišnoknjižnim diobama, otpisima i pripisima* /*Gesetz über grundbuchrechtliche Teilungen, Ab- und Zuschreibungen*] (1931).

[21] Službeni list FNRJ 84/46.

[22] The possibility of applying the legal rules has led to the belief that interruption in legal continuity was in fact only formal. In this sense Dušan Nikolić, Recepcija stranih pravila o porodičnim zadužbinama, Evropski pravnik, 3/2008, 42.

However, the provisions of Art. 4 of this Law made the implementation of legal rules contained in the regulations that were in force in the Kingdom of Yugoslavia possible, and prescribed the conditions for implementation. These legal rules could be used in cases when a specific relationship had not been regulated by the new socialist laws, and when the relevant legal rule was not contrary to the Constitution, to other mandatory legal regulations or to the morals of the socialist state.[23] Thus, for almost thirty five years, the legal rules were applied across the wide sphere of property and obligation relationships.[24] In BiH, this meant the implementation of the ABGB or the laws of the Kingdom of Yugoslavia, which were strongly influenced by the ABGB.[25]

In contrast, the Family Law (1946/47) and the Law on Succession (1955) were codified rather quickly.[26] In those two areas the application of

---

[23] For more about the implementation of legal rules see Andrija Gams, Ljiljana Đurović, Uvod u građansko pravo, Beograd, 1990, 52 et seq., Zoran P. Rašović, Građansko pravo, Podgorica, 2006, 38–39, Radmila Kovačević Kuštrimović, Građansko pravo (opšti deo), treće izdanje, Niš, 1997, 51, Martin Vedriš, Petar Klarić, Građansko pravo, četvrto izdanje, Zagreb, 2000, 19, Tomislav Borić, Eigentum und Privatisierung in Kroatien und Ungarn, Wien-Berlin, 1996, 52.

[24] In relationships of obligation the legal rules of the ABGB were applied until the adoption of the Law of Obligations in 1978, while in property law, the legal rules were applied until the adoption of the Law on Basic Ownership Relations [*Zakon o osnovnim vlasničkopravnim odnosima*] (herefter: ZOSPO) in 1980. The rules of the Land Registration Law were applied in the Brčko District BiH until 2001, while in the two entities they were applied until 2002. The same happened with civil procedure. The legal rules from the Law on Enforcement and Security Procedure [*Zakon o postupku izvršenja i osiguranja*] from 1938 were applied until the adoption of the Law on Enforcement [*Zakon o izvršnom postupku*] in 1978, while the legal rules from the Law on Non-litigation Procedure [*Zakon o vanparničnom postupku*] enacted in 1934 were applied until 1989.

[25] For more about legal rules see Mihajlo Konstantinović, Stara "pravna pravila" i jedinstvo prava in: Zbornik građanskih zakonika Stare Jugoslavije, Titograd, 1960, 3, Dušan Nikolić, Uvod u sistem građanskog prava, Novi Sad, 2007, 106–107.

[26] Codification of succession law of former SFRY was completed in 1955. The Law on Succession [*Zakon o naslijedivanju*] was a solid piece of codification. While the property, land registry and procedural laws were under the influence of Austrian law, this law was influenced by Swiss law, with certain adjustments to the socialist system (Nikola Gavella, Nasljedno pravo, Zagreb, 1990, 24). Substantive succession law in BiH essentially originates from 1955, therefore, it originates from the socialist period in both the Federation of BiH and the Brčko District BiH and it has not been changed since then. At this point some prejudices need to be revised too. As mentioned above, this was a successful piece of codification that may survive in the new circumstances with certain adjustments (for example, recognition of the succession contract, succession by partners of the same sex, etc.) In support of this statement one may look at the example of the Republic of Croatia, where a law from 1955 remained in force until 2002. The new Croatian Law on Successions has retained all basic principles of the former law. For

the legal rules of the ABGB or sharia was not possible, as distinguishing between positions of male and female successors, children born in or out of wedlock, between matrimony and extramarital community etc., was not in accordance with the new socialist principles. This divergence did not exist in property or obligations matters.

The presence of the ABGB has continued in BiH into the process of transformation. The Federation of BiH adopted numerous laws from the former Yugoslavia, by process of enacting either individual laws or a number of regulations *en bloc*.[27] The Law on Termination of Validity of the Regulations which came into force before 6 April 1941 and during the Occupation was not among the laws that were adopted by the Federation BiH, leading to the question of whether the legal rules from the ABGB could still be applied for legal gaps in the Federation of BiH. Their use is still possible, but on another legal basis. The Law on Property Relations of the Federation BiH [*Zakon o vlasničkopravnim odnosima Federacije BiH*] (hereafter: ZOVO) from 1998 does not regulate personal servitudes (*Nieß-brauch*), vicinity rights (*Nachbarrechte*), or real charges (*Reallasten*), but does stipulate that with respect to those specifically listed institutions, legal rules from the ABGB may be applied (Article 94 of the ZOVO). While adopting the Law on Obligations in the legal order of the Federation BiH, the same was stipulated with respect to gift contracts, partnership contracts and borrowing contracts.[28] In the Republic Srpska, the Law on Termination of Validity of the Regulations which came into force before 6 April 1941 and during the Occupation may still be used, as all laws in force in SFRY have been adopted into the legal system under the condition that they were not in conflict with the constitutional order of the Republic Srpska.[29]

---

further information see Tatjana Josipović, Das neue kroatische Erbrecht, WGO 2/2004, 91 et seq. The same happened with the adoption of the new Law on Successions in the Republic Srpska [Zakon o nasljedjivanju] (Službeni glasnik RS 1/2009).

[27] Ordinance with legal effect on adopting of the regulation from former SFRY[*Uredba sa zakonskom snagom o preuzimanju propisa bivše SFRJ*] (Službeni list Republike BiH 2/92), Law on confirmation of the Ordinance with legal effect on adopting of the regulation from former SFRY [*Zakon o potvrđivanju Uredbe sa zakonskom snagom*] (Službeni list Republike BiH 13/94).

[28] Art. 27 Ordinance with legal effect on adopting of the Law on Obligation [*Uredbe sa zakonskom snagom o preuzimanju Zakona o obligacionim odnosima*] (Službeni list Republike BiH 2/92, 13/94).

[29] Art. 12 Constitutional Law on Implementation of the Constitution of the Republic Srpska [*Ustavni zakon o sprovođenju Ustava Republike Srpske*] (Sl. glasnik Republike Sprske 21/92).

Interim conclusion

In one period of BiH's history, laws of a different country whose organization, economic development, history, language, culture, national structure and main religion had almost nothing in common with BiH, were implemented. While part of the Ottoman Empire, BiH had been a feudal state, whereas the Austro-Hungarian Monarchy at that time was, or at least, strived to be a modern capitalist country. Conditions in these two countries could not have differed more. One commonality could be found in the fact that the Austro-Hungarian Monarchy was a multi-national and multi-confessional country, what was also the case, albeit in a smaller area and to a lesser extent, in BiH. With the additional burden of the belief held by economic scholars that the economy held supremacy over law, and with their doctrine that law mirrored social conditions, this imposed legal transfer into a completely different social and economic context had no chance to succeed. However, it was a story with a happy ending.

In this respect, one can hardly speak about reception in its proper or historical sense, as this implies a new model being adopted at the initiative of the state (instead of having a system imposed from an external source).[30] It is possible that the lawyers of the declining Ottoman Empire considered the implementation of the Austrian Law an act of violence against the national legal spirit. Criticism was in all probability levelled at this process due to an inability to draw a line between legal irritants and legal transplants. However, today this process is positively evaluated.

The differentiated transfer process of private law is also significant. In the Kingdom of Yugoslavia the transfer did not touch on family or succession relationships, which definitely reduced the irritation (e.g. for Muslim citizens, those matters remained regulated by sharia), but areas of property, obligation and procedural laws. The implementation or influence of Austrian law continued throughout the socialist era following the same pattern. However, there was implementation of the same law within two different social and economic systems. The use of legal rules was possible in some areas (property, obligation, procedural laws), while it was more problematic in some other matters (family, succession), where codification in former SFRY was faster.

Using the example of development of BiH (1878–1990), there is one constant factor. Private law developed through the reception of laws from another state. The transfer of law was successful in some areas of private law despite the enormous differences between the source state (Austria)

[30] On the difference between reception in the past and during the transition process see in Ajani, Transfer of Legal Systems from the Point of View of the "Export Countries", 38.

and the target state (semi-feudal BiH from the end of 19th century, and socialist BiH in the second half of the 20th century). To refute transplant-sceptics,[31] it appears that the transfer or transplantation of law in certain areas of private law from one legal order into another is possible. It seems that some fundamental institutions and principles of private law are neutral in nature and may exist in different social and economic patterns. This fact enabled the continued implementation in a socialist country of laws or legal rules from laws that had been in force before 1941 for more than 30 years,[32] in the same way as it once enabled the reception of Roman law in Europe.

Which conclusions can thus be drawn from this? First of all, the reception of law that once brought so many positive elements to the entire European private law should be positively viewed as a potential instrument for the development of a legal order.[33] Autonomous development is not necessarily a loftier goal than the transfer of solutions and institutions from one legal system into another. Legal doctrine has determined that there were two types of transfers depending on the nature of legal institutions; some legal institutions being deeply culturally embedded, while others are less dependent on the culture and society. The transfer of the former is very difficult and seen as "organic", while the transfer of the latter is relatively easy and characterized as "mechanical".[34] Bosnian-Herzegovinian legal history features examples of both mechanical and organic transfers. In the areas of private law closer to the market (property law, law on obligations), the legal institutions are more neutral and their transfer was more successful, while for instance, the institutes of the law on succession and of the family law have not been transferred to a large extent.[35]

---

[31] *Teubner* believes that the term "Legal transplant" is a misleading metaphor; in his opinion, the legal irritant is a better term for this phenomenon. Also, he is sceptical about the "convergences thesis". Gunther Teubner, Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences, The Modern Law Review, Vol. 61, 1998, 12 et seq.

[32] Other former socialist countries, such as Poland shared the experiences of the former Yugoslavia, see Andrzej Maczynski, Die Entwicklung und die Reformpläne des polnischen Privatrechts, in: Rudolf Welser (ed.), Privatrechtsentwicklung in Zentral- und Osteuropa, Veröffentlichungen der Forschungsstelle für Europäische Rechtsentwicklung und Privatrechtsreform an der Rechtswissenschaftlichen Fakultät der Universität Wien, Band I, Wien, Manz, 2008, 115.

[33] This is the title of the paper Rehm (*supra* note 7).

[34] Otto Kahn-Freund, "On Uses and Misuses of Comparative Law" in Kahn-Freund, Selected Writings, London, 1978, 298 f, cited upon Teubner (*supra* note 31), 17.

[35] The same matrix is repeated in the European Community, where harmonization or unification efforts are more intensive in the area of contract law (impacting directly the functioning of the common market) than in family or succession law, where social, moral, cultural values are more expressed. In this sense, Alain Verbeke/Yves Henri

The considerations discussed in III. (*infra*) should reveal whether a successful transfer is possible within the transition process in BiH today.

III. Transfer of Foreign Legal Property Law into the Legal System of BiH as Part of the Transition Process

The former socialist states of South East Europe started departing from the socialist legal circle in the late 1980's. According to some legal writers, the implementation of reforms should also mean a return to the European continental legal circle, to which those countries belonged until the socialist revolution and the end of the World War II.[36] In case of BiH, this should imply the transfer of solutions from Austrian law; however, the influence of Austrian law is no longer the dominant factor in material and procedural civil law in Bosnia and Herzegovina, although it is still crucial to the new property law in BiH. This was also the case for the reform of Croatian property law.[37] The Property law in the Republic of Croatia served as model for the regulation of the property relationships in Brčko District BiH where the Law on Property and Other Rights *in rem [Zakon o vlasništvu i drugim stvarnim pravima*] (ZV BD BiH) was enacted in 2001,[38] as well as in the Republic Srpska where Law on Property Rights [*Zakon o stvarnim pravima*] (ZSP RS) was enacted 2009. In the Federation

---

Leleu, Harmonisation of the Law of Succession in Europe, 337, Dieter Martiny, Is Unification of Family Law feasible or even Desirable?, 313 (both in: Towards a European Civil Code, Third Fully Revised and Expanded Edition, Nijmegen, Arthur Hartkamp er al. (eds), 2004). However, some more recent developments show that those areas in BiH, and generally, are no longer exclusively a matter for national regulation; instead, they are under the influence of the values and principles set in some international agreements, primarily in the agreements sourced in international human rights law. Both the reform of the family law in Federation BiH from 2005 and the similar reform of 2002 in Republic Srpska (Law on Family of the Federation BiH [Porodični zakon Federacije BiH], Službeni list Federacije BiH 22/2005, Law on Family of the Republic Srpska [Porodični zakon Republike Srpske], Službeni glasnik Republike Srpske 54/02) have been inspired by the protection of human rights and the rights of the child sourced in international documents. In this way, BiH followed the basic principles of contemporary family law. For more about these principles see Ingeborg Schwenzer, Grundlinien eines modernen Familienrechts aus rechtsvergleichender Sicht, RabelsZ, 71 (2007), 711–712. More about new family law in Federation BiH: Suzana Bubić, Nova rješenja Porodičnog zakona Federacije BiH, Pravna misao, 9-10/2005, 11 et seq.

[36] In the same sense Gavella (*supra* note 1), 21.

[37] Gavella (*supra* note 1), 23.

[38] Službeni glasnik BD BiH 11/01, 8/03, 40/04.

BiH the adoption of an almost identical law is planned.[39] It seems as the Bosnian and Herzegovinian property law is returning to its origin.

At first glance, this seems to be a logical and positive development, particularly in the context of autonomous development and legal transplants, or even legal irritants. However, as mentioned above, the ABGB was already being criticized as outdated as a model for civil codification of the Kingdom of Yugoslavia in the 1920's, a criticism even more valid eighty years later. The reform of civil codes in some other transitional countries raised the question of whether the new Dutch Civil Code should be used as model instead of invoking the older European codifications.[40] The choice of the ABGB, with its 19th century solutions, as the model for the new property law in BiH did bring some negative consequences. The new Law on property rights for the Republic Srpska and in the Draft ZSP FBiH devotes a disproportionably large attention to vicinity rights (*Nachbarrechte*) and some easements or servitudes, for instance grazing by cattle, conducting the rainwater, etc. These institutions are no longer crucially important in a modern market based economy. In contrast, security rights over intangibles are regulated by just one single provision and non-possessionary pledges are only briefly mentioned.[41]

The principle decision to follow the tradition in the field of property law must be be viewed in light of the changes that have occurred in Austrian law and in private law generally at the European level.[42] Although property law generally had an Austrian provenance, it was also subject to other legal influences within different reform projects. Various reform projects needed be coordinated in order to the preserve coherence of the legal order. Land registry law (drafted under influence of German experts) and the future codification of property law (drafted under influence of Austrian law) shall be used as an example to illustrate the problems that may arise if some rules are not harmonized.

The legal solutions of these two areas must be mutually harmonized because of the influence the land registry law provisions have on the acquisition of immovable property rights.[43] In BiH, under pressure from the international community, priority was given to the reform of land registry law. The land registry laws in the entities were imposed by the

---

[39] Službeni glasnik RS 124/08. See the Draft of the Law on Property Rights of Federation BiH from 16 February 2007 (Draft ZSP).

[40] In this sense Vekas (*supra* note 14), 1055.

[41] Art. 144/1 ZSP RS/Draft ZSP FBiH.

[42] In this sense Gavella (*supra* note 1), 24.

[43] Meaning that the Republic of Croatia enacted the reform of land registry law during the reform process for property law.

High Representative to BiH in 2002,[44] the reformed Property Law, as already mentioned, was enacted in the Republic Srpska in 2009, although this has not yet been enacted in the Federation of BiH.[45] The reform of land registry law was undertaken with the assistance of the German experts and only partially followed the 1930/31 Austrian influenced regulations on land registries, which had been used as legal rules in BiH. This regulation was cut drastically, which cannot be seen as a positive development in the new market economy. Despite the enormous increase in the importance of public real estate records, the new entities' laws on land registries were reduced to one third of those operating in the Kingdom of Yugoslavia and socialist BiH leaving several issues completely unregulated. For instance there is no regulation for legal remedy in cases of incorrect registration, nor for giving notice of litigation, priority notice, or the authority of the notary to register the transfer of property right where he has made the notarial deed, etc. This has caused significant problems in practice.

A further problem was caused by the fact that the entities' laws on land registries anticipated certain solutions from the pending substantive property law. They provided provisions for the entry of the land charge (*Grundschuld*) and heritable building rights (*Erbbaurecht*) at a time when these rights did not exist in substantive property law. Also, they contained regulation for the registration of ownership of freehold apartments. This regulation however is in accordance with the anticipated future concept of ownership for freehold apartments or flats, which crucially differs from the prevailing concept. In the seven years since introduction, property law has not been reformed meaning substantive property law and some (substantive) provisions of the new land registries law differ enormously, which causes problems in practice.

A dilemma emerged in notary and court practice as to whether a land charge may be registered. In several cases the land charge was created by the means of a notary deed and registered in the land register. This practice ignored the fact that in BiH the *numerus clausus* principle is accepted, which means that the number of property rights is restricted and their content is standardized to a large degree by law.

Similar problems were caused by registration of heritable building rights (*Erbbaurecht*), which also had not yet been recognized in the substantive property laws of both entities. ZZK FBiH/ZZK RS adopted a legal

---

[44] More about this in Meliha Povlakić, Reforma zemljišnoknjižnog prava kao dio ukupne reforme građanskog prava, Zbornik radova sa Međunarodnog savjetovanja "Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse", Mostar, No. 1, 2003, 231.

[45] In Brčko District BiH the regulations of the property and land registry laws were adopted simultaneously and were well coordinated, and they will not be considered here.

definition of heritable building rights from German law. This was indispensible in the new regulation on land registries, since this definition was missing in substantive law and without determining the essence of a certain right, it is not possible to regulate the method of its registration. It was logical that registration provisions for heritable building rights should be implemented only after the enactment of the future property law defining those rights in detail. However, in some cases, those rights were registered in the land registries, despite the physiognomy and content of this right being unknown in the legal order of BiH. This problem occurred due to the fact that heritable building rights in the land register laws was wrongly named "the Right to Use" (*Nutzungsrecht*)[46] (Art. 26 and 29 ZZK FBiH/ZZK RS). This caused confusion as the same term was used in socialist law to describe a different institution, namely the right to limited use of land held as state property for the purposes of construction.[47]

Article 30 ZZK FBiH/ZZK RS stipulates a new method of ownership registration for a freehold apartment which relies on a concept of ownership which is still pending. This provision cannot be fully implemented in practice until the new property law adopts a new definition and regulation for ownership of a freehold apartment. The method of registration is not feasible with the current substantive provisions. Nevertheless, some land registry offices registered the ownership of a freehold apartment in accordance with the provisions of Art. 30 ZZK FBiH/ZZK RS, modifying the provisions to suit the applicable law, which necessarily implied interpretation and implementation *contra legem.*

In the Republic Srpska, Art. 30 of the Law on Land Registries was amended on 16 November 2008. The amendments provided a new regulation for the registration of ownership of a freehold apartment, which was in accordance with the existing concept of this institute. For a very short period of time – substantive and procedural provisions related to the ownership of a freehold apartment were in accordance. But on 27 December 2008, only one month later, the new Law on Property Rights was enacted adopting the new concept of ownership, leaving the Republic

---

[46] When it comes to foreign support for the development of laws, language problems and problems of translation should not be ignored.

[47] In the legislation of the Federation BiH different rights to use still exist, however, these are not right *in rem*, and unlike building rights, they are not transferable or heritable. Furthermore, the mode of registration for the socialist "right of use" was completely different under the socialist system. This problem does not exist in the Brčko Distrikt BiH since 2001 – the old rights of use were abandoned in the new codification of property rights. The same situation existed in the Republic Srpska as in the Federation BiH until 2006, when the socialist rights of use were definitively abrogated by enacting the new Law on constructing land [*Zakon o građevinskom zemljištu*], Službeni glasnik Republike Srpske 112/06.

Srpska once again with inconsistent substantive and procedural provisions. Responsibility for this invidious situation rests predominantly with the Ministries of Justice of both entities, which allowed so many years to pass between the reform of the land registry and property laws (an expert team lead by the GTZ (*Deutsche Gesellschaft für Technische Zusammenarbeit*) had submitted a draft version of the property law to the Ministries of Justice of both entities as early as 16 February 2006).

Furthermore, in both entities, ownership of freehold apartments will be regulated in the future codification of property law in accordance with the Austrian concept, whereas the registration of ownership of freehold apartments in the land registries laws was adopted from German law. This is problematic, as regulation follows the German substantive provisions for registration, while the Austrian concept differs significantly.

New problems will occur with the entry into force of the Law on Property Rights in the Republic Srpska and the future adoption of a similar law in the Federation of BiH, as the future codification of property law will not take all solutions into consideration from previously adopted entities' laws on land registries which had already been in force for seven years. This particularly applies on acquisition of property right on real estate.

In substantive property law the entry in the land registry is considered an essential condition for effectuating a change in property ownership but only when the acquisition was made through a legal transaction (Art. 38 ZOVO, Art. 33 ZOSPO). The laws on land registries have brought a radical novelty, according to which an entry in the land registries always has a constituting effect no matter what means of acquisition was used (by transaction, by law, by court decision). Only in cases of acquisition by succession the entry has a merely declaratory act (Art. 5. ZZK FBiH/ZZK RS). Provisions of substantive and land register laws strongly differ with regards to this basic issue of property law, with this radical change being accepted in Bosnian and Herzegovinian practice for almost seven years of implementation. However, new laws on property rights will again include the old solution: the entry in land register will have a constituting effect only when property rights are acquired by means of legal transaction. Regardless which solution is more suitable, such a significant change within a relatively short period of time does not really promote legal security.

IV. Collateral Law in BiH

1. Security rights over movable property

The reform of securities on movable assets, which primarily means the introduction of non-possessory securities into the legal system of BiH,

does not necessarily imply a return to legal tradition and acceptance of the Austrian legal provisions. It is absolutely clear that Austrian law could not be a model for reform in this field of civil law. With its rejection of non-possessory securities over movable property, Austrian law is regarded as a curiosity within the European Union.[48]

German regulation on this issue was also inappropriate; currently there is no German regulation for non-possessory securities over movable property, German solutions are the results of more than a hundred years of doctrinarian research and proposals as well as creative judicial practice. Furthermore, the main features of the German secured transactions, the fiduciary transfer of property or claims and the non-existence of publicity make this law a complex subject for export.

Bosnia and Herzegovina did not follow the example of some other countries in the region; the system of non-possessory securities over movable assets was created without introducing the institute of fiduciary property (*Sicherungsübereignung*) into the Bosnian and Herzegovinian legal system. This form of security, which had been removed from Roman law, but restored in German law for very specific reasons, is redundant in countries allowing non-possessory, or registered pledges. This principal decision was a very reasonable one, although only Bosnia and Herzegovina and Serbia did not incorporate fiduciary securities into their law; otherwise this institution is widely applied in the region and exists in parallel to the non-possessory pledge on movable assets. In Croatia, Macedonia and Montenegro, the fiduciary transfer of property is provided also for immovable assets, which represents a deviation from the German original.[49]

In BiH registered pledges were adopted for the first time in the period from 2000 to 2002. Identical laws on registered pledges over movable assets and shares were adopted in both Entities and in Brčko District BiH.[50] The Polish approach was used as a model for the drafting of these statutes, however they have never been implemented, as it was considered irrational to establish three separate registers in the small territory of BiH.

---

[48] See more by Katarina Andova, Das Mobiliarpfandrecht in Österreich, Ungarn, Tschechien und Slowakei, Wien, 2004, 14, Martin Schauer, Das Register für Mobiliarsicherheiten in Österreich: Rechtsdogmatische und Rechtspolitische Grundlagen, in: M. Schauer (ed.), Ein Register für Mobiliarsicherheiten im österreichischen Recht, Wien, 2007, 11–14.

[49] Criticism of the adoption of the institution of fiduciary property from German law in transitional countries without the adoption of the entire doctrinal and judicial infrastructure, as well as on the application of this institute on immovable property by Meliha Povlakić, Fiducijarno vlasništvo u usporednom pravu i sudskoj praksi, Zbornik Pravnog fakulteta Sveučilišta u Rijeci (1991) v. 24, br. 1, 2003, 221 et seq.

[50] Službeni glasnik Republike Srpske 16/2000, Službeni glasnik Brčko Distrikta BiH 9/2000, Službene novine Federacije BiH 17/2002.

These statutes followed the principles and nomenclature of the BiH legal provisions and even though they were a complete novelty they were not legal irritants. However, the anticipated register of the securities over movable assets and the procedure and effects of registration were inspired by the law on land registers. The court decided upon an application for registration which would then have a constitutive effect. It was clear, based on the experience of other countries, that the role of the court in the registration process, the creation of rights and the examination of applications for registration would delay registration and lead to ineffectiveness.

These provisions have instead been replaced by the Framework Law on Register Pledges [*Okvirni zakon o zalogama*] (OZZ) which is uniform for the entire country and is highly influenced by Article 9 of the United States Uniform Commercial Code.[51] The fact that this law was enacted at the state level, even though the constitution does not explicitly authorise the BiH state to regulate this issue, can be evaluated in two ways. Firstly, it was the only reasonable solution that provided the necessary central electronic register for the entire country. However, the need to adopt other laws at the state level (e.g. Law on Obligations, Property Law) also exists. These projects supported by the German organization GTZ, are the subject of resistance, especially in the Republic Srpska. The influence of American aid in developing a state level enactment for the Framework Law on Register Pledge was called into question. In the case of the reforms supported by GTZ, under the same constitutional basis, it would not have been possible to pass the relevant laws at the state level. This is not a legal but rather a political question and it is mentioned here only to illustrate how the decisions regarding the direction of the reform are being made.

OZZ represents a complete codification of the register pledge, stipulating the requirements for the creation of pledge rights, organization of the register, registration process and enforcement over personal property encumbered with a registered security. This law accepted basic principles which have already been adopted by Art. 9 UCC.[52] All forms of personal

---

[51] The same happened in Montenegro, Kosovo and Romania. More by Christa Jessel-Holst, Reform des Mobiliarsicherheitenrechts in Südosteuropa, 73, Miloš Živković, O reformi realnih obezbeđenja u jugoslovenskom pravu, 319, both in: Das Budapester Symposium (*supra* note 1); Julian Teves, Die Mobiliarsicherheiten im deutschen und rumänischen Recht unter Einbeziehung des französischen und US-amerikanischen Mobiliarsicherungsrechts, Münster, 2004, 43; Meliha Povlakić, Aufbau und Funktion der Register für Mobiliarsicherheiten in Südosteuropa, Evropski pravnik 1/2008, 37.

[52] More about the key features of Article 9 see Harry C. Sigman, Security in movables in the United States – Uniform Commercial Code Article 9: a basis for comparison in: Eva-Maria Kieninger (ed.) Security Rights in Movable Property in European Private Law, Cambridge, 2004, 56–60, Matthias Creydt, Die Besicherung von Weltraumvermögenswerten, Frankfurt am Main, 2007, 51.

property, present as well as future property (tangible and intangible) can be encumbered by a registered security. Every obligation can also be secured and this regulation is applicable to all types of debtors and creditors. Security interests as defined in UCC are slightly different. The Bosnian and Herzegovinian legal system does not provide for a unitary security device; rather each security device is subject to the same rules. There are different securities in the legal order of BiH, which are created in accordance with the provisions of different statutes. However, according to the provisions of OZZ they are all subject to a uniform principle – registration is generally the only relevant consideration for priority ranking. Therefore, although registration does not have a constitutive effect, it is crucial for the priority ranking of different securities.

BiH adopted an information system listing possible interests on some property. This register is a publicly available database, but only accessible after the payment of prescribed fees. The procedure of registration is simple, fast and effective. In fact – there is no procedure of registration in the sense of a court or administrative procedure. The research and registration are conducted by the creditor who can directly register his right, without the participation of the court and without an examination of the application *au fond*. All procedural steps have to be performed electronically. Settlement of secured creditors is subject to special enforcement rules, which are more flexible and efficient than general enforcement procedure.

Banks in BiH use this regulation regularly. The feedback is very positive and it seems that this legal transplantation was successful. The functional approach of Art. 9 UCC provisions makes them neutral and applicable under different legal systems. This regulation has already inspired very different national legal orders, both continental and common-law legal orders, but also some international documents.[53] The comparison of classic solutions from countries in the region which followed the legal tradition (Croatia, Slovenia, Serbia and Macedonia) with the solutions inspired by Art. 9 adopted in BiH, Kosovo, Montenegro and Romania, have shown that the latter are more efficient and appropriate for transactions within a modern credit oriented economy.[54] The foreign origin of these

[53] The example of several states of the United States of America or Kanada, which belong to the civil law and not to the common law tradition is interesting: The basic idea of art. 9 UCC was adopted in Louisiana and the Personal Property Securities Act was adopted in Quebec. T.C. Nelson, R.C.C. Cuming, Harmonization of the Secured Financing Laws of the Nafta Partners: Focus on Mexico, 7, Sigman (previous note), 54. This experience was used during the reform of security rights in movables in Romania. Teves (*supra* note 51), 44.

[54] See more in detail by Meliha Povlakić, Aufbau und Funktion der Register für Mobiliarsicherheiten in Südosteuropa, 70 et seq.

legal solutions does not detract from this positive result. However, it is still only a partial success since some possibilities offered by this regulation still remain unused.

The legal technique used in some Anglo-American influenced statutes is very strange to domestic lawyers. Even a well-prepared and deliberate transfer from another legal system into the Bosnian and Herzegovinian system can fall at this obstacle. There are several legal provisions in the Framework Law on Register Pledge which are completely incomprehensible to an average jurist in BiH, without special insider knowledge of the US-American model of secured transactions.

The definitions are key for understanding the concept and philosophy of Art. 9 UCC[55] and OZZ. This is the most problematic feature of the OZZ, which has legal definitions that are not really compatible with the principles and the structure of the Bosnian and Herzegovinian legal order. Some of these definitions are absolutely superfluous in a systematised continental legal system based on general institutions and principles. It is redundant to define legal institutions such as contract, pledge, assets etc. These superfluous definitions are also confusing, as several definitions vary from the usual definitions given by other statutes or by doctrine, including inter alia, the definitions of court and statutory pledge, leasing and retention of title. This has significant practical consequences and may undermine the entire concept. Furthermore, the terms used to nominate these institutions in some cases do not have any meaning in BiH or have been already used for other legal institutions.

All security rights over movable assets, no matter what their nature, can be registered and the relationship between them is merely determined by the moment of registration. According to OZZ in addition to registering a contractual pledge, it is also possible to register a court or a statutory pledge. The priority of all pledges depends on the moment of registration. In practice this provision remains almost completely unused, since court and statutory pledges are described with terms unknown to the Bosnian and Herzegovinian legal order. This has led to the application of only one of the possibilities offered by the law with the consequence that only contractual pledges and leases are being registered. Therefore the application of one of the core principles of this law has been frustrated, with the register database, which could offer complete information on all encumbrances on a certain asset, in fact only contains data on contractual securities.

Besides this separate law on non-possessory registered pledges, in the future codification of property law in both entities and in the existing codification of the Brčko District BiH, there are provisions on possessory security rights over movable assets. There has been no attempt to include cer-

[55] Sigman (*supra* note 52), 55.

tain principles with a general character for application to both possessory and non-possessory securities over moveable assets in the codification of property law. The only provided is that non-possessory pledge over movable assets is regulated by the separate law (Art. 144/1 ZSP RS/Draft ZSP FBiH). Registered non-possessory pledges and classic pledges (*pignus*), the latter having no greater practical value, thus exist completely independently from each other. This situation is exacerbated by procedural law – the classic pledge is effectuated in the enforcement procedure before the court under the application of general rules of enforcement, whilst the registered pledge uses the special rules of enforcement as stipulated by the OZZ. The enforcement procedure defined by the OZZ represents a considerable aberration from the classical enforcement procedure on movable assets, and only a mere subsidiary application of general enforcement law is provided.

Is such division possible and desirable? The OZZ is essentially neutral towards the *pignus* as well as towards other security measures; these are regulated by other provisions and come into existence in accordance with other provisions, but have to be registered to receive a certain priority ranking. The possessory pledge is only mentioned in the OZZ in this regard. In cases where dispossession has occurred before the registration of a second creditor, the priority of the creditor secured by the *pignus* will not exist as his right is not registered,[56] highlighting the fact that only registration is relevant for priority between two rights.

The creditor of a possessory pledge on movable assets or rights, whether established on the basis of a contract, statutory provision or a court decision, has recourse to regular enforcement procedures. The more flexible and effective enforcement procedure is available to creditors with non-possessory securities resulting from a registered contractual pledge, however, creditors with a registered judicial or legal pledge are also required to recourse to the general enforcement procedure. This procedure constitutes a problem, not only for the creditors but also for the courts. Where the court seeks to enforce a contractual possessory pledge or a court pledge, it applies one set of rules, but a different set of rules must be applied to the enforcement of a registered contractual pledge. The situation becomes even more complicated if the court acts upon the enforcement claim of one creditor secured by a contractual registered pledge while a court and statutory registered pledge exist on the same object at the same

[56] At this point Bosnian and Herzegovinian law deviates from the solution of the UCC. There is no provision for the attachment of security rights. OZZ differs only with regards to the creation and registration (perfection). Only the creation of a contractual non-possessory pledge over movable assets is regulated by OZZ; the creation of other securities is stipulated by other regulations.

time. In accordance with the relevant enforcement provisions, three procedures are relevant: for the registered pledge, the procedure stipulated by OZZ; for the court pledge, the procedure governed by the laws on enforcement procedure; and for the statutory pledge, a specific administrative proceeding in accordance with the laws on tax administration!

The above was intended to demonstrate the effects of what was, to all intents and purposes, a very satisfactory solution, namely, the transfer of the registered pledge system virtually unchanged from the American model into a foreign legal system. In interaction with the local legal framework however, it lost its intended effect. Legal literature has already noted that transferred laws require significant assimilation into the local legal network,[57] however, some problems found in BiH could have been easily avoided by better translation and the use of appropriate terminology when preparing the laws for registered pledges.

2. Security rights on intangible assets

Security rights on intangible assets will be regulated in the future codification of property rights in both entities, and are already regulated in Brčko District BiH, by only one legal provision. In contrast, the pledge on intangibles such as some rights, claims etc. was regulated in detail by the Law of Obligations adopted from the former Yugoslavia (Art. 989–996 Law on Obligations). This law enacted in 1978 could not be considered as a socialist law, as it is consistent with modern laws and was influenced by the Swiss Law of Obligations,[58] and was adopted from former SFRY almost without amendment in both entities as well as in Brčko District BiH. The influence of Swiss law is very evident in the modern and detailed regulation of pledge rights over intangible assets. In the ABGB, security rights on intangible assets were not foreseen, however legal scholars have extracted the possibility of pledge rights on intangible assets out of the broad definition of objects of property rights contained in Art. 285 ABGB, according to which the object of property rights can be tangible or intangible in nature. However, in Austrian law, it is not stipulated how security rights on intangibles have to be created, so that the means of acquiring security rights over certain intangible assets is highly controversial.[59] Based on this experience, the new regulation of property law stipulated with only one provision that intangible assets are pledged in the same way as they are transferred (Art. 150 ZSP RS/Draft ZSP FBiH). In this respect

---

[57] Teubner (*supra* note 31), 19.

[58] Ewoud Hondius, Jugoistočna Evropa i evropsko privatno pravo, Evropski pravnik, 1/2006, 22.

[59] S. Helmut Koziol/Rudolf Welser, Bürgerliches Recht, vol. 1, 13th ed., Wien, 2006, 381.

the former provisions of the Law of Obligations were clearer and mirrored the increased importance of these legal institutions, which means that "reform" meant two steps backwards.

3. Security rights on real estate

a) General remarks

In former SFRY the hypothec was regulated by only seven provisions governing some basic issues. These provisions were adopted from the former SFRY and were in force in the Republic Srpska until 1 July 2009 and are still in force in the Federation BiH. It is evident that these legal provisions do not comply with the increased role and importance of the law on hypothec since the end of the socialist legal system and the establishment of the market economy. This minimal approach to the regulation of the hypothec has substantially hampered the development of a modern credit economy. In bank and judicial practice, problems arose mainly from the strict accessory nature of the hypothec, which caused it to become a very inflexible security. In both entities (in the Republic Srpska until 1 July 2009) even securing future and conditional obligations is problematic, as there is neither a maximum amount mortgage, nor can a hypothec be used to secure claims of fluctuating amount in order to provide security for revolving credits. It is also not possible to dispose of an extinguished but still registered hypothec.[60]

The Law on Property and other Property Rights in the Brčko District BiH adopted the solutions of the Croatian law in principle, which relies on the ABGB (Art. 125–137 ZV BD BiH for hypothecary law). However, ZV BD BiH has not adopted the solutions of the Croatian law in its entirety. Without any reasonable explanation, the regulation for extinguished but still registered hypothecs has been omitted, whereas the retention of priority for a future hypothec is possible, along with the registration of a future hypothec at the same priority ranking as one already in existence. The Law on Property Rights of the Republic Srpska, as well as the Draft of the Law on Property Rights in Federation BiH, completely adopted the Croatian law approach (and that of Austrian law with regard to the aberration from the principle of accessoriness). The conclusion could be that hypothecary law *de lege ferenda* in BiH is of Austrian provenance, whilst the adoption of an institute from German law – the land charge (*Grundschuld*) was intended for the Federation BiH.

---

[60] On the other hand, all mentioned deviations from the principle of accessoriness exist in the laws of other countries, established through the dissolution of the former SFRJ: see Meliha Povlakić, Zemljišni dug u usporednom pravu, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, vol. 26., br. 1., 2005, 211 et seq.

However, the story does not end here. Hypothecary law does not only consist of substantive property law, but also formal law, i.e. land register, public notary, enforcement and insolvency law, since these branches of law represent its infrastructure. Insolvency and notary law are principally influenced by German law, whilst enforcement law is principally and traditionally rooted in Austrian law. The project of introducing the notary public in BiH has shown very positive results from a short period of application, especially regarding securities in real estate transactions,[61] and more effective protection for secured creditors. The latter is due to the ability of the notary deed to act as an executive title. This is for the main part a consequence of a deliberate transfer of German legal provisions, but also due to the issuance of by-laws, the education of notaries and the conduct of exams, which was carried out with support of the GTZ.

Additionally, enforcement law, traditionally influenced by Austrian law was not conceptually changed. The reform of enforcement law was effectively prepared by a group of domestic experts, without foreign intervention, Scandinavian experts and GTZ were only partially involved. The GTZ contribution extended to ensuring the notarial deed functioned as an enforcement title and that enforcement over non-registered real estate is only possible under the condition of prior registration in the land register. The primary intention of the enforcement laws, as it was stated in the drafting materials, was to retain the existing framework whilst making it more efficient. This meant first and foremost, the abandonment of one core principle of socialist enforcement law – the principle of sociality i.e. the protection of the debtor. The newly adopted provisions however went too far in the other direction by almost completely ignoring the protection of debtors and third parties within enforcement procedure – leading to appeals before the Constitutional Court BiH for violation of property rights.[62] This showed that domestic legal practitioners engaged as experts by the reform process oftentimes are not able to create a successful reform on their own. Reform of this kind, requires some doctrinal knowledge and knowledge of comparative law trends as well as practical experience, as shown by other countries' experiences in attempting reform without academic involvement.[63]

---

[61] In the Federation of BiH notaries started practising in May 2007, followed by the Brčko District BiH in November 2007 and later in the Republic Srpska (March 2008).

[62] See criticism by Asaf Daupović et al, Komentari Zakona o izvršnom postupku u Federaciji BiH i Republici Srpskoj, Zajednički projekt Vijeća Evrope i Evropske Unije, Sarajevo, 2005, Nr. 1–12. See also Decision of the Constitutional Court of BiH [Odluka Ustavnog suda BiH], AP 1086/04 from 2 December 2005.

[63] Ajani, La circulation de modèles juridiques dans le droit post-socialiste, 1101.

It is fortunate, that the reforms of property law, land registry law, notary law, insolvency and partially enforcement law were undertaken with the support of the same entity (GTZ), due to two positive side effects. First, GTZ offered solutions, which originated in the continental European legal system, which is not completely alien to the BiH legal system and secondly, reforms were mutually coordinated to a certain extent. Still, even reform projects conducted in such a manner encounter certain problems, with attitudes in the country of reception the key variable. Legal reforms supported by GTZ were not an automatic process of adoption of provisions from the same legal system (solutions of the Austrian and German law were adopted at the same time) nor were the reforms of the same quality, often due to subjective elements, such as the personality of the foreign expert appointed to lead the project, cooperation with domestic experts, the quality of domestic experts and the attitude of the relevant ministry towards a certain project.[64] The reform of securities on movable assets was not undertaken with assistance from GTZ at all. It is absolutely clear that such different pieces of legislation cannot be perfectly harmonized with each other and that, as a result, collateral law in BiH remains a patchwork of laws, and complicates the implementation or interpretation of the new rules. This short overview of property and collateral law should be used as an illustration of the methods applied in the reform of different fields of law and the transfer of foreign instruments. In practice, decisions were made *ad hoc* under different influences and the country of reception did not do anything to coordinate the different legislative projects.

b) Legal hypothec

There is one very interesting issue related to the legal hypothec. The regulation regarding the legal hypothec of the state for tax debts as well as the procedure of tax collection was drafted with the support of American experts. This issue was regulated in separate laws, with the aim of securing tax collection, but at the same time, adopting solutions which endanger other secured creditors. In the former socialist legal system of BiH a general hypothec was forbidden, but the Law on Tax Administration explicitly provides for a general hypothec *in favour* of the state for unpaid taxes.[65] In the Federation BiH and Brčko District BiH, a legal hypothec comes into being without registration in the land register, which is contrary to the

---

[64] On the influence of this fact, see: Chanturia (*supra* note 5), 119.

[65] Art 50 of the Law on Tax Administration of the FBiH [*Zakon o poreskoj upravi FBiH*] (Službene novine FBiH 33/03, 28/04), Art. 68 of the Law on Tax Administration of the Republic Srpska [*Zakon o poreskoj upravi RS*] (Službeni glasnik RS 112/2007), Art. 50 of the Law on Tax Administration of the Brčko District BiH [*Zakon o poreskoj upravi BD BiH*] (Službeni glasnik BD BiH 3/02, 42/04, 8/06, 3/07, 19/07).

solutions of the respective Law on Land Register and endangers the security of creditors secured by means of a contractual hypothec. Furthermore, contrary to the socialist law on enforcement procedure, which had envisaged the collection of taxes only through a court based enforcement procedure, the new provisions enabled a separate settlement of tax debts through an administrative procedure, which additionally jeopardizes the priority rating and settlement opportunities for contractually secured creditors. The legal changes having occurred in BiH with the aim of protecting secured creditors have been partially frustrated by the tax administration laws, thereby seriously endangering the credit economy.

c) Land charge

This fractured picture of collateral law over real estate in the Federation BiH could be exacerbated by the inauguration of a legal concept from German law – the land charge.[66] If those solutions are adopted in the Federation BiH, this will lead to a situation where, at the same time, there is a hypothec influenced by Austrian law operating as an accessory right with some deviations from this principle, and the land charge from German law as a non-accessory security right over real property. This fact does not have to be irritating *per se;* in German law both institutes exist in parallel, whilst the land charge has gained more approval in practice.

The experiences of Slovenia, which was the only country of former SFRY to regulate the land charge, show that implementation was performed hesitantly and did bring some problems in practice.[67] The reason for this may be the minimal regulation in the Property Rights Code of the Republic Slovenia[68] (Art. 192–200) of this very sophisticated institution. Successful adoption of the land charge from German law will not be achieved through a mere transplant of provisions from the BGB, as it is not really regulated by the statutory provisions, but through German doctrine, judicial and bank practice. A successful transfer requires the transfer the entire German "Acquis" of the land charge, which is definitively more problematic than simply adopting foreign statutory provisions. This problem was recognised in the Federation BiH, with the result that the German

[66] Until the last version of the Draft-Law, the land charge was also intended in the Republic Srpska.

[67] Matjaž Tratnik, Landesbericht Slowenien, in: Otmar Stöcker (Red.), Flexibilität der Grundpfandrechte in Europa I, Schriftenreihe des Verbandes deutscher Pfandbriefbanken, vol. 23, Berlin, 2006, 371.

[68] Uradni list Republike Slovenije [Official Gazette of the Republic Slovenia] 87/2002, 18/2007.

law in action in this field was adopted in the actual drafting process of land charge regulations.[69]

The draft ZSP FBiH, lists different types of land charge, including the securing land charge (*Sicherungsgrundschuld*), used to secure a monetary claim. The Security Agreement (*Sicherungsvertrag*), which establishes the accessoriness *inter partes*,[70] is a legal category as well. The security agreement lays down the preconditions for the realisation of the land charge; minimum content is stipulated by the law (Art. 196 of the Draft ZSP FBiH).[71] The objections which the owner of encumbered real property can raise against the creditor as well as the consequences of the settlement of the creditor or termination of the land charge are also stipulated (Art. 193 and 194 of the Draft ZSP FBiH). Some of these issues were not originally dealt with in the BGB before the latest amendments in 2008.[72]

The rules on objections of the owner of an encumbered real property against the holder of the land charge are clearly set: the owner of the encumbered real property can refuse to satisfy the original (first) creditor beyond the amount of the secured claim and raise other objections to the secured claim (e.g. non-existence of the secured claim, nullity of the secured claim). Against a third party, which acquired the security right from the first creditor, objections can only be raised if this third party knew or ought to have known that the right was created to secure a claim at the time the security right was transferred. The right of the owner to place objections is excluded if the third party acted in good faith. The right to object arises directly from the law, regardless of whether the security agreement stipulates this right or if the agreement has been concluded at

---

[69] For this method of regulation: Povlakić, Zemljišni dug u usporednom pravu, 253. Also basic guidelines for a non-accessory security right were used, which were drawn up by the expert group whose establishment was initiated by the Association of German Mortgage Banks (now Association of German Pfandbriefbanks). Hans Wolfsteiner/Otmar Stöcker, A non-accessory Security Right over Real Property for Central Europe, Notarius International 1-2/2003, 116–124.

[70] Cf. Soergel/Stöcker, EU-Osterweiterung und dogmatische Fragen des Immobiliarsachenrechts – Kausalität, Akzessorietät und Sicherungszweck, ZBB-Report, 5/02, 416., Harry Westermann, Sachenrecht, 7th revised ed., Heidelberg, 1998, 807, Hansjörg Weber, Kreditsicherheiten, München, 1994, 228.

[71] The legislator in the Federation BiH followed the guidelines for a non-accessory security right over immovable assets. See Wolfsteiner/Stöcker (*supra* note 69), 119.

[72] In 2008 two provisions were added to the part of BGB dealing with land charge. These additions were a result of the enactment of the Law on Risk Limitations concerning Financial Investments [*Gesetz zur Begrenzung der mit Finanzinvestitionen verbundenen Risiken – Risikobegrenzungsgesetz*] from 12 August 2008 (BGBl I S 1666). Generally these amendments introduced the securing land charge, which was not previously a legal category, and the limitation of the non-accessoriness of this kind of land charge.

all. To what extent these provisions can diminish the fears and resistance of a non-accessory security mainly depends on the definition and extent of good faith, which will be determined not only by the law, but also by the interpretation of the courts. Nobody can be considered as acting in good faith if the land register contains some notice of the security nature of the land charge. It is also possible to opt for a complete exclusion of the transfer of a land charge in the security agreement (Art. 192 Sec.1 of the Draft ZSP).

It is yet unclear whether this will be sufficient to ensure the successful operation of this institution in practice. As already mentioned, this institution is a highly sophisticated legal instrument, operating predominantly to the advantages of banks. However, not even the banks themselves show interest in implementing a non-accessory security on real estate; in all probability, as they have not yet discovered its advantages. It has to be noted that banks were only first confronted with the problems concerning the accessoriness of the security rights on immovables a few years ago. Also the literature in the former SFRY or BiH just started to show interest for this issue,[73] whereas this issue has intensively occupied German doctrine for a long period of time.[74]

Amongst Bosnian and Herzegovinian lawyers, there is a great resistance to the implementation of this institute (partly due to the lack of information). This is possibly due to the need for protection of legal security; protection of the owner, particularly when the owner or debtor is a consumer; and the potential for abuse by transferring the land charge to a third party. The accessoriness protects the debtor from twofold payment,[75] and it is held that this protection does not exist with non-accessory means of secu-

---

[73] Povlakić, Zemljišni dug u usporednom pravu, 211 et seq., Tatjana Josipović, U potrazi za eurohipotekom, Liber Amicorum Nikola Gavella, Građansko pravo u razvoju, Zagreb, 2008, 256, 276 and 277 et seq., Darja Softić, Akcesornost hipoteke kao prepreka pri primjeni modernih tehnika finansiranja, Zbornik radova, 6. međunarodno savjetovanje Aktualnosti građanskog i trgovačkog zakonodavstva i pravne prakse, Mostar, 2008, 618 et seq., Miloš Živković, O uvođenju tzv. neakcesornih založnih prava na nepokretnostima u pravo Srbije, Aktuelna pitanja građanske kodifikacije, Zbornik radova, Niš, 2008, 195 et seq.

[74] Wolfgang Mincke, Die Akzessorietät des Pfandrechts, Berlin, 1987, Dieter Füchtenbusch, Der Akzessorietätsgedanke in der modernen Entwicklung des Hypothekenrechts, Münster, 1960, Ekkehard Becker-Eberhard, Die Forderungsgebundenheit der Sicherungsrechte, Bielefeld, 1993, Dieter Medicus, Durchblick: Die Akzessorietät im Zivilrecht, Juristische Schulung, 10/1971, Ulrich von Lübtow, Konstruktion des Pfandrechts und der Reallast, in: Festschrift für Heinrich Lehmann zum 80. Geburtstag, vol. I, 1956. Jürgen Baur/Rolf Stürner, Sachenrecht, § 36 III, 401–405, Westermann (*supra* note 70), 681 et seq., Hans-Jürgen Lwowski, Das Recht der Kreditsicherheiten, Berlin, 2000, 42 et seq., 196 et seq. and 211 et seq.

[75] Medicus (previous note), 503.

rity such as the land charge. It is a fact that the higher negotiability of the secured right increases the risk of misuse. However, in all countries arising out of the former Yugoslavia, crucial aberrations of the principle of accessoriness are provided for, which prove that strict accessoriness of the hypothec is an obstacle for modern financing techniques. This represents a strong argument for an additional non-accessory security right over real estate also in BiH. In order to protect the owner of the encumbered property in BiH, there was no possibility to stipulate his personal liability (*abstraktes Schuldversprechen*); the liability of the owner is only limited to this real estate.[76]

In addition to these social reasons there are also certain dogmatic concerns against the introduction of the land charge. Some authors characterize the land charge also as an abstract security.[77] This abstractness has often been linked with the system of acquiring rights *in rem* in German law, which other European countries including BiH do not have. The differentiation between the underlying contract (*Verpflichtungsgeschäft*) and the real agreement (*Verfügungsgeschäft, Einigung*) is the most important feature of German law,[78] with the purpose of protecting third parties and the security of legal transactions. In the terms of classification given by Drobnig[79], both BiH and Germany accept the principle of delivery for the contractual transfer of property. Unlike German law however, which uses the principle of separation, BiH relies on the principle of unity; meaning there is no difference between the underlying and the real agreement. The question of the relationship between the underlying contract and the contract which actually transfers the property right does not arise, but it is important to note that an invalid sales contract cannot form the basis for the transfer of property. The governing principle in BiH is not the principle of abstractness but the principle of causality.

It is important to note that the adoption of the institute of the land charge does not mean the adoption of the principle of abstractness from German law which is the main objection against the introduction of the land charge into the legal systems based on the principle of causality.

---

[76] On issues concerning personal liability of the owner in Germany cf. Heinz Gaberdiel, Kreditsicherung durch Grundschulden, Stuttgart, 2000, 144 n. 297, Christian Marburger, Grundschuldbestellung und Übernahme der persönlichen Haftung, Berlin, 1998, 56, 123, Uwe Blaurock, Aktuelle Probleme aus dem Kreditsicherungsrecht, Köln, 176. Against the introduction of this institute into legal order of BiH – Povlakić, Zemljišni dug u usporednom pravu, 241.

[77] Weber (*supra* note 70).

[78] Münchener Kommentar/Eickmann, § 1191 Rn. 10, Ulrich Drobnig, Transfer of Property, in: Towards European Civil Code, Third Fully Revised and Expanded Edition, Arthur Hartkamp et al. (eds.), Nijmegen, 2004, 737.

[79] Drobnig (previous note), 726.

Occasionally, when the subject of the abstractness of the land charge arises in German law, some authors in fact discuss the abstractness of the transaction of property rights,[80] and not a special feature of the land charge itself. The entire issue could be concluded with one sentence – the abstractness of the land charge has nothing in common with the principle of abstractness in acquiring property rights. German law, based on the same principle of acquisition for all rights *in rem*, also has the hypothec as an accessory and the land charge as a non-accessory and "abstract" means of securing claims. In German law, it is not only the land charge that is abstract and therefore different from the hypothec, but "each property right (including the hypothec) is abstract in relation to the underlying contract".[81] The principle of causality or the principle of abstractness, which governs the relationship between the underlying contract and the real agreement, has nothing in common with the principle of non-accessoriness, regulating the relationship between the security right and the secured claim.[82]

Both social and dogmatic concerns against the introduction of the land charge can be refuted but there are other weak points – including whether the judicature or other legal practitioners in a transitional country are able to apply the complex legal institute of the land charge, to identify and avoid the risks which may arise for the owners of encumbered real estates or the granters of the security.[83] The countries wishing to adopt this approach, should consider all aspects of providing securities by means of land charge (including the risk of oversecurity and of misuse, which may result from the fiduciary character of the land charge). Particularly the countries whose consumer protection provisions are not in accordance with European standards, should consider to improve consumer protection (e.g. risk of unfair terms in general terms and conditions stipulated by the banks).[84]

---

[80] Weber (*supra* note 70), 226.

[81] Münchener Kommentar/Eickmann, § 1191 Rn. 10.

[82] Soergel/Stöcker (*supra* note 70), 415, Westermann, (*supra* note 70), 683. Accessoriness relates to the relation between the real agreement i.e. the right which originated out of it and the claim. Münchener Kommentar/Eickmann, § 1191 Rn. 11.

[83] Povlakić, Zemljišni dug u usporednom pravu, 253, Živković, O uvođenju tzv. neakcesornih založnih prava na nepokretnostima u pravo Srbije, 207.

[84] The German judicial practice and doctrine considered very often the issues of protection of the debtor or consumer. For more information see Baur/Stürner (*supra* note 74), § 45 II 23, Cf. Clemente, Die Sicherungsgrundschuld in der Bankpraxis, Köln, 1985, 45 et seq.

V. Concluding remarks

The subtitle of this Conference suggests that there is an alternative between autonomous development on one side and reception, transfer and transplant of laws on the other. The alternative however, is only an illusion, because in the transition process transplantation is unavoidable. In other words, in a country of transition the dilemma is not whether to adopt the solution of another legal order, but rather how – in order to avoid the mutation of the legal transplant into a legal irritant.

A comparison with a medical example can be made here. In some cases even though the organ of the donor may perfectly correspond with the body of the receiver, the success of the operation is not guaranteed. It is possible that surgeons may not perform to their best; conditions in the operating room may be unhygienic. The transplant alone is not responsible for a successful transplantation, but several other factors. The mistakes in the transfer process in BiH are often the results of incompetent domestic authorities and their indifferent attitudes, rather than the quality of the transferred solutions.

In each transitional country the question arises as to whether the state's structure, judicial system, and administrative bodies are able to conduct quick and qualitative reforms as well as applying them adequately? In BiH this question became even more delicate due to its complex state organization. It is obviously impossible for each of the 14 legislative bodies in BiH to have enough capacity for such a task. The involvement of the international community and different governmental and nongovernmental organizations in the legislative reform process in BiH is more acute and delicate than in other transitional countries, dramatically increasing the chances that any legal solutions offered will be uncritically transferred from another or several other legal systems. The new laws are usually prepared within a short time period,[85] by almost anonymous domestic or foreign "experts," without public debate, or any involvement by domestic academics and often with a last minute change in Parliament. These factors have a crucial influence on the quality of the transfer.

Furthermore, almost fifteen years after the war ended, the constitutional organization of the state of BiH is still highly debated, which distracts attention from other important issues. Namely, the economic and legal reforms required for the association of BiH to the European Union or other integrations, as well as preconditions for certain international grants, set up by the international community, need to be fulfilled within a certain period

[85] More on this issue in general see Dušan Nikolić, Recepcija stranih pravila o porodičnim zadužbinama, 40.

of time. The legislators in BiH are often unable to fulfil these requirements and often there is simply no political will to do so, lending the international community an occasional Janus face for its role in the reform process in BiH. International involvement is often desperately needed but at the same time, as already stated in legal writing, these organizations, who will later become lenders and creditors, tend to initiate, support or design the reform along their own needs. Technical support and the exercise of influence together with the imposition of their own legal provisions, without due care for the legal tradition or other previous reforms, often goes hand in hand.

For a successful transfer, while it is necessary to conduct the reforms partly in concert with domestic experts, it is also necessary to manage reforms in such way as to take advantage of different influences and to coordinate them. BiH can be considered as a paradigmatic example of a transitional country in the region, which has been exposed to different legal influences without the essential domestic engagement.

Property Law in Serbia: Both Autonomous Legal Development and Legal Transplant*

DUŠAN NIKOLIĆ

* This paper is partly based on the results of research conducted during a scientific project titled *Serbian Law in European Perspective* (No. 149042), financed by the Ministry of Science and Technological Development of the Republic of Serbia, as well as on research performed as part of the scientific and developmental project titled *Harmonization of Laws of the Republic of Serbia and the European Union – theoretical, sociological, historical, substantive, and economic aspects*, funded by Novi Sad Faculty of Law. This paper has been structured in accordance with the *Private Law Questionnaire* as prescribed by the Max-Planck Institute for Comparative Law and International Private Law in Hamburg.

I. Introduction

There are numerous testimonies for the transplantation of regulatory models from one legal system to another. Legal rules, as well as legal principles, have been subject to transplantation. This type of mixing and intertwining of different legal cultures can be explained by the natural tendency of human societies to seek understanding for each other, cooperation and connection at different levels. It is a long-lasting and, it appears, irrevocable process, conducted within regional and global integration.

Adoption of legal rules and principles from a foreign law system, which is known in continental Europe as *reception* (*receptio*), is of special importance for countries that aspire to joining the European Union. To a great extent, the reception of law simplifies the entire process of accession and offers assurance to candidate countries that they will not make mistakes in regulating relevant subject matter. Connecting to the legal system of an individual developed country offers protection from diverse foreign influences that may cause confusion and instability in the legal system. Further, reception solves the problem of interpretation and application of new normative solutions. Together with regulatory solutions, doctrinal interpretation, commentaries and examples from court practice, as well as legal literature, all of which require considerable human resources and time, can all be adopted as well. At the same time, reception may cause a multitude of negative effects, as witnessed by the experience in Eastern Europe.[1]

Acceptance of high legal standards and reception of concrete regulatory solutions from foreign legal systems, which are ill-suited to the level of social development, increases the discrepancy between what is prescribed by the law and what exists in reality. There are numerous examples of the *dead laws* in the East European countries. The existing regulations are modern in their design but are often not applied in practice. Normative solutions contained in such regulations are often so far from reality, that

[1] See: Dušan Nikolić, *Harmonizacija stvarnog prava na prostoru Jugoistočne Evrope*, (*Property Law Harmonization in the Region of South-East Europe*), in: *Beiträge zur Reform des Sachenrechts in den Staaten Südosteuropas*, Bremen, 2003; Dušan Nikolić, *Ujednačavanje stvarnog prava – putevi i stranputice*, Tematski Zbornik Pravnog fakulteta Sveučilišta u Rijeci posvećen prof. dr Petru Simonettiju, 3/2003, str. 297–316.

consistent application thereof would cause major shocks to the society. In grasping the existing situation in the East Europe, some western analysts claim that *true law* exists, a law that is only a *façade law*, or a *shadow law*.[2] In certain areas two parallel regulatory systems coexist. One is official, and is not applied in practice, while the other is informal and effective.[3] These circumstances can serve to increase the insecurity of citizens.

Based on current experiences it may be concluded that the reception of foreign law is desirable and justified in many cases, however it must be harmonized with the real needs of the particular target society. This applies to Serbia as well. A short retrospective of the most significant events in the history of the Serbian property law, which shall be presented on the coming pages, indicates that there have been varying levels of success in the reception of law. The reception of law was in some cases useful, while sometimes it produced far-reaching negative consequences. However, this does not mean that reception should be rejected *a priori*. A legal system should be developed autonomously, to the furthest extent possible. A founder of a well known Anglo-American *Theory on Legal Transplantation* concluded in one study that "the nation which is clever in creating law does not depend on accepting [legal] transplants, not *even in the time when the foreign influence is very significant for other issues in the society* [emphasis added]."[4] On the other side, the fact is that reception has always existed and it will exist into the future, but it is important that it should be adequate and functional. Therefore, the answer to the question on reception should read: a country should adopt both autonomous legal rules and legal transplants.

II. General Characteristics of Property Law in Serbia: Western Legal Culture, European Tradition, and National Specificities

Serbian Property Law has historic connections to the culture of Indo-European, in particular Slavic, peoples. It is based on a Roman-law heritage. It belongs both to the Western legal culture and to the group of legal systems

---

[2] See: Friedrich-Christian Schroeder, *"True" Law, "Façade" Law, "Shadow" Law*: *International and National Law and Eastern Europe, Essays in Honor of George Ginsburg*, 2001, pp. 355–360.

[3] See: András Sajó, *Pluralism in Post-Communist Law,* Acta Juridica Hungarica, 1–2/ 2003, p. 14.

[4] Alan Votson, *Pravni transplanti* (Alan Watson, *Legal Transplants*)*,* Beograd, 2000, pp. 149.

of the continental European type. Other branches of the civil law belong to the Germanic legal circle.[5]

In contrast to most other European countries, Serbia does not have a civil code. Legal rules covering property law can be found in several laws and other types of legal sources. Also, legal regulation of this branch of law is incomplete and, in some areas, unclear. However, recently a public discussion commenced on a pre-draft of the *Law on Property* to regulate this branch of law in detail. Further, a new *Serbian Civil Code* is also in preparation. These two projects define a general framework within which Serbian property law will develop in the future.

The word "*development*" denotes a process that is changing over time and space. In that process we have a certain *causative sequence*. The future is based on the present and the present is based on the past. A discussion on *what is* and *what is going to be*, requires the knowledge of *what was*. The previously cited founder of the Anglo-American theory on *legal transplants* himself points to that fact by stating that "the law is to an astonishing degree rooted in the past."[6] In acknowledging the need to give an overview of the historic heritage, and in keeping with the predetermined scope of this paper, we shall make reference only to the most significant events and circumstances, the corner stones that have determined the direction of development of property law in Serbia.[7]

III. Key Events in the History of the Serbian Property Law (in ten points)

*1. The First Europeanization: Reception of Roman (Byzantine) law***.** an encounter with the Byzantine culture and Roman legal heritage, which occurred in the 7th century at the time of extensive settlement of Slavic peoples in the area of South East Europe, had a detrimental influence on the foundation and development of property law. At that time, Serbs lived in accordance with old customary law, which was characterized by *collective property* and the wide authority of the head of the family. Over time, customs gave way to written sources of law – *nomocanons*, which at first were entirely taken from the Byzantine, and later were adapted to the tradition and particularities of the Serbian people. This was the *first reception*, and

---

[5] For more detail see: Dušan Nikolić, *Uvod u sistem građanskog prava*, IX izdanje (*Introduction to Civil Law System*, IX edition), Novi Sad, 2008.

[6] Votson (*supra* note 4), p. 144.

[7] For more detail see: Dušan Nikolić, *Osnovni izvori stvarnog prava*, Novi Sad, 2007, pp. 5–65; Dušan Nikolić, *Osnovni pravci razvoja stvarnog prava u Srbiji*, Evropski pravnik / European Lawyer Journal, 1/2008, pp. 77–106.

at the same time, the *first Europeanization of the law*. Towards the end of the Middle Ages, Serbia was, according to distinguished foreign historians, "much closer to Middle European states than Byzantine".[8]

2. Return to Customary Law at the Time of Turkish Occupation. Serbia lost its statehood in the middle of the 15th century when Sultan Mohamed II the Conqueror turned it into one of his provinces. During the occupation, which lasted for several centuries, Serbian people, for the most part, lived in accordance with customs. Thus, *customary law* developed under the strong influence of the Turkish authority and Eastern culture.

3. Emergence of the Serbian Legal Elite in Hungary. Fleeing from repression, a great number of Serbs accepted military service in neighboring Austria. For centuries these men formed elite border troops who played a key role in the defense against the Turks. Serbs received numerous privileges for their distinguished military service – ranging from the right to trade with their brethren in occupied Serbia to religious, cultural, and later territorial autonomy within Hungary. Such privileges contributed to the creation of influential bourgeois strata which was composed of military aristocrats and wealthy merchants. Bourgeois families produced distinguished Serbian lawyers that, for a certain period of time, played a leading role in Hungary, and then the first doctors of juridical science (Sava Popović Tekelija[9], 1786; Teodor Filipović, 1803; Gligorije Trlajić; Jovan Hadžić 1826[10], and others). These lawyers were the founders of Serbian legal studies and the key actors in the second Europeanization of Serbian law which was initiated at the end of 18th and the beginning of 19th century, first in Hungary and later in Serbia itself.

4. The Second Europeanization: Development of law in the Period of Uprisings. At the time of the first Serbian Uprising in 1804, led by Đordje Petrović – Karađorđe, the aim was to establish a modern state in which all of the major social relations, including property relations, were to be regulated by law. One of the pivotal protagonists of this idea was Teodor Filipović, renowned Austrian lawyer and professor of legal history at the University of Harkov, who was known among rebels under the alias

---

[8] Konstantin Jireček, Jovan Radonić, *Istorija Srba (kulturna istorija, knjiga II)*, Beograd, 1984., p. 117.

[9] See: Sava Tekelija, *Dissertatio ivridica de cavsa et fine civitatis* (*Doctoral dissertation on the Cause and Purpose of the State*), Novi Sad, 2009. Bilingual edition (in Latin and Serbian language) with contributions in Serbian and English, prepared by Matica Srpska Society.

[10] See: *Disertatio inauguralis iuridica de causis matrimonium dissociantibus juxta disciplinam ortodoxae ecclesiae christi orientalis*, Budae, 1826.

Božidar Grujović. His contemporaries considered his ideas to be reasonable but they feared that realization of such progressive ideas in the circumstances would have been premature.

A considerable advancement in these areas was only achieved in 1830s, when two Austrian educated lawyers of Serbian origin, came to Serbia on the invitation of *Knez* (Duke) Miloš Obrenović. One of them was Jovan Hadžić (the first President of Matica Srpska Society and a senator at the Magistrate in Novi Sad), who was entrusted with the task of writing the *Civil Code*. Hadžić suggested to the *Knez* to give up the plan of reception of the French Code Civil, claiming that foreign provisions would be ill-suited for the Serbian people and that because of the discrepancies in social and economic development, an original code should be created. Despite this position, Hadžić submitted a text to the *Knez,* which was in essence a shortened and somewhat edited version of the Austrian Civil Code.

5. Enactment of the Serbian Civil Code of 1844: Reception of Foreign Law and its Consequences. Hadžić's draft, with certain amendments, was adopted in 1844 under the title *Civil Code of the Dukedom of Serbia*. The adoption of the Code was of epochal significance. Serbia became one of the few countries in Europe at that time to have a civil code. This in turn defined the basic path for the development of civil law legislation. By carrying out a partial reception of Austrian law, Serbia had acceded to the Germanic legal sphere to which it still belongs today in the field of private law. Furthermore, it should be mentioned, that the acceptance of normative approaches from foreign law did in fact hasten changes in society. Serbia began to develop in accordance with the legal standards which were being upheld in Central and Western Europe. Despite all of this, the Civil Code had a number of shortcomings.

One of the main criticisms was that Jovan Hadžić did not grasp the real meaning behind the Serbian family clan (*porodična zadruga*) and that he had contributed to the dissolution and disappearance of these communities with the acceptance of unsuitable normative approaches from foreign property law.[11] Certain authors considered this to be a reason for the spread of poverty among Serbian families and the destabilization of society as a whole, the consequences of which are felt even today. Of course, other opinions exist among theorists. For example, Slobodan Jovanović, a re-

[11] See: Živojin Perić, *Zadružno pravo po Građanskom zakoniku Kraljevine Srbije,* Belgrade, 1912; Živojin Perić, *Zadružno nasledno pravo po Građanskom zakoniku Kraljevine Srbije,* Belgrade, 1913; Živojin Perić, *Porodično zadružno pravo u Crnoj Gori,* Branič, 11–12/1925, pp. 217–222; Živojin Perić, *Porodično zadružno pravou Hrvatskoj i Slavoniji,* Arhiv za pravne i društvene nauke, Volumes XI, pp. 349–384.

nowned Serbian intellectual and professor of the Belgrade Faculty of Law, considered that Jovan Hadžić simply hastened a process that was otherwise unavoidable.[12]

6. Planned Creation of Legal Elite in Serbia in the Second Half of the XIX Century – Various western influences. Law making clearly pointed out the weaknesses of Serbian society, which at that time, was trying to integrate into the 'civilized' circle of Europe. For the most part, the population was illiterate and uneducated, and the country lacked educated lawyers. The practice of purchasing clerk's positions from the state inherited from the Turkish times left doors wide open to corruption and legal insecurity. Also lacking was the legal infrastructure for implementation of modern normative solutions from developed European countries. However, the greatest problem was that Serbia lacked an intellectual elite which could steer the development of society in the right direction. More specifically, the country did not have sufficient educated people capable of understanding events in the neighborhood, who were able to critically analyze those events and make decisions of strategic importance on the way towards European integration. In 1839, the planned creation of the intellectual elite had begun. According to the program drafted by the Minister of education of the time, Stefan Stefanović – Tenka, each year a certain number of state pupils were sent to leading European universities (Budapest, Vienna, Berlin, Heidelberg, Halle, Jena, Paris, Lyon, Geneva etc.). It is estimated that up until Serbia's join the South Slav union of peoples – The Kingdom of Serbs, Croats, and Slovenes, approximately 1,300 students of various callings were educated in this manner.[13] Most of them studied law, as the creation of legal professionals for courts and other state organs was considered to be a national priority.

7. Work on the Harmonization and Unification of Law in the Kingdom of Serbs, Croats and Slovenes: a failed attempt at reception. At the time of creation of the Kingdom of Serbs, Croats and Slovenes, in 1918, the *principle of legal continuity* was applied. In all parts of the new state, existing regulations continued to be implemented. Legal particularism presented itself as an obstacle to a stronger economic, commercial, and political integration of the region. For this reason, the central government, immedi-

---

[12] Slobodan Jovanović, *Jovan Hadžić*, in the book: *Političke i pravne rasprave*, Beograd, 1908 (updated edition: Belgrade, 1990). pp. 285. This premise may be supported by the fact that similar changes occurred in the territory of Croatia and in some other regions. For more detail see: Nikola Gavella, *Stvarnopravno uređenje u hrvatskom pravnom poretku*, Evropski pravnik/European Lawyer Journal, 4/2007, pp. 29–80.

[13] See: Ljubinka Trgovčević: *Planirana elita,* Belgrade, 2003.

ately following unification, began the process of developing a unified legal system. However, from the outset, priority was given to regulations in the domain of public law. A committee for the preparation of a preliminary draft of the uniform civil code was not formed until 1930. From the very beginning, it faced numerous legal and political problems. Of particular difficulty were the differences in legal development between certain territories. It is generally considered that because of this discord, the working group decided to use the Austrian Civil Code of 1811 as a starting point. Moreover, it was considered that this Code was much closer to the general law in force in the Kingdom, than Swiss civil law legislation or, for example, the German Civil Code of 1896. Furthermore, practically all legal territories, more or less, had developed under the influence of Austrian law prior to unification. It had become, directly or indirectly part of the common legal tradition. Hence, it was believed that the official reception of normative solutions from the Austrian Civil Code would cause the least resistance from the political and professional spheres. These predictions, however, proved to be wrong. The preliminary draft of the new civil code, better known as the *Predosnova* [Preliminary Foundation], was completed in 1934. The project was submitted to the Ministry of Justice the following year. Soon after, public discussion followed. The *Predosnova* was severely criticized.[14] This criticism was directed at the proposed provisions, and also at the drafters' decision to use the Austrian Civil Code as the basis. Many considered that Swiss legislation should have been used instead,[15] while others claimed that the country needed a completely original codification, which would equally take into account the domestic tradition and heritage of Central and Western European countries.[16] The *Predosnova* never reached the parliamentary procedure phase. Hence, World War II and the break up of the Kingdom of Yugoslavia came about without appropriate laws in the area of civil law, and therefore property law.

8. Disruption of Continuity of Legal System of the Kingdom of Yugoslavia. Following the end of World War II in Yugoslavia, the creation of a new legal system began. In February 1945, a *Decision on Nullity of all Regulations Enacted by the Occupying Power and their Aides during Occupation;*

---

[14] See: Bertold Eisner, Mladen Pliverić, *Mišljenja o predosonovi Građanskog zakonika za Kraljevinu Jugoslaviju*, Zagreb, 1937; Živojin M. Perić, *Obrazloženje §§ 1.-319. Predosnove Građanskog zakonika za Kraljevinu Jugoslaviju*, Belgrade, 1939.

[15] Certain authors claim that the members of the Committee took into consideration some of the solutions from the Swiss Civil Code. See: Ferdo Čulinović, *Dražavnopravna historija jugoslavenskih zemalja XIX. i XX vijeka (Srbija, Crna Gora, Makedonija, Stara Jugoslavija (1918–1941), Nova Jugoslavija, Knjiga II, Zagreb, 1959,* pp. 321.

[16] For more detail see: Božidar S. Marković, *Reforma našega građanskog zakonodavstva*, Beograd, 1939.

on Validity of Decisions Enacted in that Period; on Nullity of Legal Regulations that were in Force at the Time of Enemy Occupation was proposed.[17] In October 1946, this Decision became a law titled the *Zakon o nevažnosti pravnih propisa donetih pre 6. aprila 1941 i za vreme neprijateljske okupacije* (*Law on Nullity of Legal Regulations Enacted Prior to 6 April 1941 and during the Enemy Occupation*).[18] Legal regulations existing before the war were nullified. However, the break-up with old order was much more obvious in the public law domain than in private law as post-revolutionary practice proved that society could not function without some traditional civil law principles. The legislators made a compromise. The Regulations of the Kingdom of Yugoslavia were no longer enforced, but the legal rules contained within them could, under certain conditions, be applied even in the new legal environment. Some of these legal rules are still apply today in the field of property law.

9. Short-term Influence of Soviet Ideology: "Class Laws" (Nationalization and Collectivization). The field of property law was gradually and partially regulated in post-war period. Under the influence of Soviet legal doctrine, the first issues to be regulated were those of a class character, including: in 1946 – Law on Nationalization of Private Commercial Enterprises; 1953 – Law on Agricultural Land Funds and the Allocation of Land to Agricultural Organizations; 1954 – Law on Purchase and Sale of Land and Buildings; 1957 – Law on Expropriation; 1958 – Law on Nationalization of Rented Buildings and Construction Land; 1959 – Law on the Use of Agricultural Land; Law on Business Buildings and Facilities; and Law on Property on Building Segments. During that period a massive collectivization of property, mostly agricultural lands, took place. However, the process of collectivization was never fully carried out due to different circumstances.

10. Shift in Development of Socialistic Law: Social Self-governance and Social Ownership. A certain shift in development occurred as early as 1948, at the time of ideological clash of socialist Yugoslavia with the USSR and other member states of the Communist block. The state had undertaken nationalization and collectivization measures up until the end of 1950s. However, private property was not abolished, instead, the state determined a maximum amount of goods that an individual citizen could posses. It was possible to dispose of property in legal transactions *inter vivos* and *mortis causa* and there was a broadly cast freedom to enter into a contract. In 1960s, the law took an even more liberal spirit. From that point

[17] Decision was published in Official Gazette of DFJ, no. 4/1945.
[18] Law was published in Official Gazette of FNRJ, no. 86/1946.

on, the legal system became closer to the Western European model than to that of the countries under so called '*real socialism*'.

Around that time, a development of *social self-governance* and *social property* began to develop. The fundamental idea was to transfer the regulation of most social relationships to the *non-state sector*, social (non-governmental) organizations and worker's organizations. This was in fact an attempt to conduct a *privatization of legal regulation*. The aim was to have society independently enact and apply rules of conduct known as *social agreements* or *self-governance agreements*, with the state only intervening when necessary. It is not too difficult to recognize an idea of development of the *civil society* in these efforts, which is of high value today. The society had property at its disposal which was neither private nor state owned. It belonged to everybody and, at the same time, to nobody. The structure of the economy was also very unique. It was not a *planned* economy, as in the countries belonging to the Eastern Block, but nor was it a *market* economy as in the West. A unique model of economy was developed, namely, Yugoslavia had what was known as an *agreement economy*. Territorial communities and commercial enterprises jointly determined business and development policy, without direct influence from the state. The exchange of goods took place on the free, single Yugoslav market. Classical legal regulations belonging to the field of civil law, that is property law, were being developed parallel to the *civil society*.

IV. The idea and Process of Codification

1. The Work on Codification of Civil Law and Constitutional Changes in the 1970s

In the first years after the Second World War an opinion prevailed that the field of civil law should be regulated by law without delay. The end goal was to enact a single civil code for the whole state. However, a suggestion was to apply a method of partial codification in order to overcome gaps in law. The idea was to enact one law for each branch of law, which would later, without significant changes, be incorporated in a broader text. Hence, at the end of 1940s a set of laws regulating family maters was adopted (*Principle Law on Marriage* (1946); *Principle Law on Relations between Parents and Children* (1947); *Basic Law on Custody* (1947); *Child Adoption Law* (1947)); that were all prepared by Mihailo Konstantinović, a distinguished professor at the Belgrade Faculty of Law. Laws enacted later were also based on drafts prepared by Professor Konstantinović, and those were the *Law on Statute of Limitation* (1953) and the *Inheritance Law* (1955). In 1960, the professor was entrusted with the task of preparing a

draft law for contracts and torts. Work on this project was finished in 1969. A few months later, his "*Draft for a Law of Obligations and Contracts*" was published.[19] The author opted for a *creative codification of the law on contracts and torts*. The Draft represented a successful synthesis of a great number of original normative solutions and the best regulative models taken from comparative law. Judges, barristers and lawyers working in commerce started to rely on these formally non-binding rules proposed by Professor Konstantinović. The Draft represented what we refer to in Europe today as *soft law* in the period between 1969 and 1978.[20] The work on codification continued in other areas of civil law as well. A special committee was formed in 1964 for writing a *Pre-draft for Law on Rights in Rem*, which however, never became law. At the end of sixties, the work on the general part of civil code was completed. The only thing left to be done was to harmonize the regulation in force with the drafts and to unify them. For that purpose, a Committee for the revision and codification of the Federal laws was formed by the Federal Assembly in 1968. A year later the Joint Committee of the Federal Assembly for a Civil Code was formed. Soon after, however, important constitutional changes took place which changed the delegation of jurisdictions between the federal and member-state level, which in turn made the creation of a unified civil code impossible. With Amendment XXX to the Constitution of the SFRY from 1963, approved in 1971, it was envisaged that the Federation would: "regulate contractual and other obligation relationships dealing with the exchange of goods and services; the principle of ownership and other rights which provided for single market; the principle of ownership rights in sea-commerce, internal voyage and air traffic; and also regulate intellectual property rights".[21]

Regulation of other matters was delegated to the Republics. This delegation of legislative jurisdictions was confirmed by 1974 Constitution of SFRY.[22] So Yugoslavia, instead of getting long awaited unified civil code, received unique disintegrated civil law divided into eight legal territories. As the constitutional basis for the creation of a single civil code was lacking, the only thing left to do was to regulate the individual areas of the civil law.

The Federation, within its competency passed the *Zakon o osnovama svojinsko-pravnih odnosa* (*Law on Fundamental Property Law Relations*)

---

[19] See: Mihailo Konstantinović, *Skica za zakonik o obligacijama i ugovorima*, Belgrade, 1969.

[20] See: Dušan Nikolić, *Trideset godina Jugoslovenskog Zakona o obligacionim odnosima*, Evropski pravnik/European Lawyer Journal, 4/2008, pp. 7–11.

[21] Amendment XXX, para. 2, pt. 3 (OJ SFRY, no. 29/1971).

[22] See: Art. 281, para. 1, pt. 4. Constitution (OJ SFRJ, no. 9/1974).

in 1980.[23] This law was subsequently amended on two occasions (1990[24] and 1996[25]).

A working *Draft of the Law on Ownership Rights and Other Related Rights over Real Estate*, was completed in Serbia in 1978.[26] After expert discussions, a conclusion was reached that the Law should cover property rights over movable property.[27] The working version was completed soon after. The text was subsequently changed on several occasions; however, the Draft was never enacted as law. Other member states also failed to pass the required regulations falling within their respective competencies before the break-down of Yugoslavia. Gaps in the law were filled with legal rules from pre-World War II legislation and by invocation of the principles of civil law.

In Serbia in 2003, the *Law on Pledge over Movable Things Recorded in the Registry*[28], and in 2005 the *Law on Mortgage* came into force.[29] The former law was influenced by the Anglo-American law and it was written in the spirit of the European Continental law.

2. Creation of the Draft Law on Ownership and Other Property Rights in the 2000s

Preparations for comprehensive regulation of property law commenced at the end of October 2003 when on the basis of a decree from the Ministry of Finance and Economy of the Government of the Republic of Serbia, a working group for work on a draft on ownership relations was formed. The work was completed, for the most part, in July of 2006. The working group made the Draft with almost seven hundred articles, providing detailed regulation for property law. Due to this, the Draft was presented to the public with a new, more ambitious title. Instead of *Draft Law*, it was titled *the Draft Code on Ownership and Other Property Rights*.

The Draft was written under the dominant influence of the German legal system. This conclusion can be drawn from the total number of provisions

---

[23] The Law on Fundamental Property Law Relations was published in OJ of SFRY, no. 6/1980 dated 18 February 1980.

[24] See: The Law on Amendments and changes of the Law on Fundamental Property Law Relations (OJ SFRY, No. 36/1990; dated 29 June 1990).

[25] See: The Law on Amendments and changes of the Law on Fundamental Property Law Relations (OJ SFRY, No. 29/1996; dated 26 June 1996).

[26] The text was published in Anali pravnog fakulteta u Beogradu, 3–4/1978, pp. 231–299.

[27] See: Obren Stanković, *O dosadašnjem radu na kodifikaciji stvarnog prava i karakteristikama Zakona o pravu svojine i drugim stvarnim pravima na nepokretnostima*, Anali Pravnog fakulteta u Beogradu, 3–4/1978, str. 225/229.

[28] Official Journal of the Republic of Serbia, 57/2003.

[29] Official Journal of the Republic of Serbia, 115/2005.

and from a detailed analysis of the proposed normative solutions. Despite that, it is beyond doubt that members of the working group kept local legal traditions and current developmental needs in mind, as well as the European standards in the area of the property law.

The length of the Draft was determined by several factors. A new political, economic, and legal atmosphere brought about the need to regulate many issues not covered by existing legislation. In certain instances, a more precise regulation of relevant relationships was needed. Finally, the Draft includes some of the legal principles contained in laws that address other branches of civil law.[30]

This exhaustive character that sometimes borders abstract causation, deviates to a great extent from the existing under-regulation. If the proposed text is adopted by the National Assembly of the Republic of Serbia, lawyers will need considerable time to get acquainted with the extensive regulations. Citizens will need even more time. However, it is beyond doubt that legal security will be raised to a much higher level.

3. Third Europeanization: Decollectivization, Denationalization, Privatization and Restitution

The Draft Law on Ownership and Other Property Rights does not solve all of the problems relating to ownership. Still many crucial, or even vital questions remain unanswered.

On several occasions during the 1990's, an equality of all ownership forms was proclaimed. Constitutional provisions, as well as provisions of other laws, guaranteed equal protection of social, state, private and cooperative property. At the same time, the *ownership transformation* began, and endures to this day. One of the predominant approaches is to transform socially owned assets into other forms of ownership. This process represents a type of *decollectivization*. The property of non-state entities (collectives) is transformed into state or private property. The aim is to alleviate uncertainty caused by the concept of socially owned property, primarily the non-existence of the titular, which is recognizable and acceptable by Western standards. As in other transitional states, this process results in social division and a high degree of social uncertainty among citizens.[31]

---

[30] For more details see: Vladimir V. Vodinelić, *Osnovno o Nacrtu stvarnopravnog zakonika Srbije 2006*, u knjizi: *Ka novom stvarnom pravu Srbije – Nacrt Zakonika o svojini i drugim stvarnim pravima (Auf dem Wege zu einem neuen Sachenrecht Serbiens – Entwurf eines Gesetzbuches zur Regelung des Eigentums und anderer dinglicher Rechte)*, Belgrade, 2007, pp. 13–16.

[31] For more detail see: Dušan Nikolić, *Funţia socialâ a dreptului de proprietate privatâ (trecut, prezent, viitor), Pandectele Române*, Wolters Kluwer Romania, 2007, str.

Alongside *decollectivization* is the process of *denationalization*. Assets owned by the state are gradually being transferred to private ownership. This is the process of *privatization* or *re-privatization* through public auctions and other methods of sale, all in accordance with special legislation. Experts are predominantly of the opinion that the sequence of actions was not appropriate. Namely, Serbia has only partially undergone the process of restitution for property taken from its previous owners through nationalization, confiscation, and compulsory collectivization. Thus, sales of goods realized as a consequence of denationalization, should be unwound in order to honour existing special rules.

It became clear that the restitution of seized property should be regulated by a separate law. This issue is covered in *The Draft Law on Denationalization*, which was presented to the experts in Fall of 2007.

Summa summarum, a conclusion can be drawn that these processes would have been completed with fewer negative effects had the whole matter been regulated with one law or one code.

4. Towards a New Serbian Civil Code

In November 2006, the Government of the Republic of Serbia issued a resolution on the establishment of a Committee for the Drafting of a Civil Code. This defined, in principle, the development strategy of law in this area. The aim was to codify and harmonize civil law, including property, with European legal standards and the approaches adopted in international conventions.

For now, the fundamental branches of law have been only partially codified. Serbia has a rich nomenclature of legal sources. Legal norms are found in the Constitution, laws, ratified international treaties, bylaws and autonomous acts of non-state actors. In addition this, under certain conditions, the rules contained in the provisions of the former Kingdom of Yugoslavia can be applied, as well as a variety of customary laws (good business customs; usages), etc. Just as in other countries of continental Europe, primacy is given to state provisions. Autonomous rules are only applied if referred to by statute or if the statute renders their application possible under certain conditions.

Customary law is also applied in the area of property law. It has particular significance in the regulation of relations between neighbors. There are many matters in this area which are not governed by laws in power. In these cases, citizens and the courts rely on rules which have been created spontaneously through the life of the community itself.

69–78; Dušan Nikolić, *Civilno društvo i civilno pravo* (*Civil Society and Civil Law*), in: *Liber Amicorum Nikola Gavella – Građansko pravo u razvoju*, Zagreb, 2007, pp. 51–68.

5. The Impact of Free-Market Economy Thinking on Post-1990 Private Law Reforms

Serbia's private law is being developed in a relatively new legal environment. The change which took place in the 1990s was not as great as in countries of real socialism. The legal system of the former Socialist Federal Republic (SFR) of Yugoslavia was in many segments much closer to western legal rules than to the legal standards which were applied in Eastern Europe. As a result, the changes in the manner of thinking and the regulation of social relations in the former Yugoslav republics were much smaller. This is particularly the case in the Law of Obligations, which has undergone only slight amendments.[32] The greatest changes took place in the area of property law.

The Law on Fundamental Property Law Relations was first amended in 1990.[33] The amendments were directly connected to changes in the political and economic systems within the country.[34] In accordance with the general determination to render all forms of property equal, the statutory provisions favouring socially-owned property were amended. This was the beginning of a process of systemic changes (transition) of property relations which is still ongoing. A considerable number of amendments dealt with the property rights of foreign physical and legal persons. The legal status of foreigners has been improved considerably.

Constitutional and statutory changes which brought about the abolishment of limits to property rights (the so-called maximum) regarding agricultural land, apartments, houses, etc., also significantly influenced the development of social relations.

The Law on Fundamental Property Law Relations was amended for the second time in 1996.[35] The amendments were greater in number and broader than the previous. First, terms and provisions with ideological connotations (morals of socialist self-governing society, etc.) were removed. Citizens, civic associations and civil-legal persons were simply changed to become physical and legal persons. The result of this was to place an emphasis on the equality of all actors regarding the acquisition, enjoyment

---

[32] See: Ratomir M. Slijepčević, *Origin and Characteristic Features of the Concept of the Law on Obligation Relations*, Evropski pravnik/European Lawyer Journal, 4/2008, pp. 13–28.

[33] See: Zakon o izmenama i dopunama Zakona o osnovnim svojinsko-pravnim odnosima (Law on Amendments to the Law on Fundamental Property Law Relations), Official Journal SFRY No. 36/1990, 29 June 1990.

[34] See: Amendments IX–XLVII to the SFRY Constitution (Official Journal SFRY No. 70/1988).

[35] See: Zakon o izmenama i dopunama Zakona o osnovnim-svojinskopravnim odnosima (Law on Amendments to the Law on Fundamental Property Law Relations), Official Journal SFRY No. 29/1996, 26 June 1996.

and protection of property. The process of making all forms of property equal was continued, as was the prohibition on the acquisition of property rights and real servitude through positive prescription over socially owned assets.

The amendments provided that physical and legal persons could have property rights with respect to certain property in general use and on municipal constructions sites, as well as forests and forestland, within the confines of the law.

Foreign national and legal persons could also acquire ownership and other property rights on movable assets and real estate in Yugoslavia. In relation to the acquisition of chattels, foreigners were equated with domestic citizens.[36]

Long-term leases were more thoroughly regulated. These amendments provided that foreigners could lease real property for a period of five to thirty years, with the possibility of extending the lease.

The liberalization of the economy also greatly influenced the reform of pledge rights. Based on the model of a developed market economy, a *pledge of movable assets recorded in the registry* (*registered pledge*), and the previously rarely used *mortgage* was adapted to modern business needs.

Summa summarum, it can be said that Serbian property law is much more liberally designed than before. There is no doubt that normative comparative law approaches contributed to this. Relying on foreign experiences is common in open societies and Serbia, in that sense, is no exception. The reception has perhaps been a little slower and narrower than in other eastern European countries. In addition, it can also be said that a systematic and coherent approach was lacking. Some normative approaches were taken from the legal system of individual European countries, while others were taken from Anglo-American law (e.g. *registered pledge*). This has created a certain amount of confusion and a lot of ambiguity, not only among scholars, but legal practitioners as well. Finally, some normative approaches from abroad were plainly inadequate for this level of social development. Their introduction into the legal system could create serious and long-term consequences. Clear evidence of this is the experience provided by the abolishment of family clans (*porodične zadruge*) in the nineteenth century, as well as the current trend of including family endowments (*porodične zadužbine*) into Serbian law, which is addressed at the end of this paper.

---

[36] See in detail: Maja Stanivuković, *Svojina i druga stvarna prava stranaca na nekretninama u Jugoslaviji,* Zbornik radova Pravnog fakulteta u Novom Sadu 1–3/1996, p. 223–235.

A unique problem is the fact that Serbia has continued to develop in the spirit of liberal capitalism during the period of global financial and economic crisis which has forced many wealthy countries to turn to state interventionism and long-suppressed state capitalism. It is almost as if the fact has been forgotten that a new era and new circumstances require new rules.

V. The Influence of European Community Private Law

In Serbia, the Europeanization of certain sectors of private law began as early as the mid-1990s. The greatest advancement was achieved in the area of intellectual property. In other sectors, this process made ground after the democratic changes in the fall of 2000. In January 2002, a Unit for European Integration was formed as part of the Ministry of Foreign Economic Relations, and a few months later, a separate Sector for European Integration as well. The Council for European Integration was established in June 2002 as an advisory body to the Government and a Committee for the Coordination of the EU Accession Process in October. In June 2003, the Government adopted the Action Plan for the Harmonization of Laws with EU Regulations. In the meantime, additional strategic acts were adopted. This created the necessary conditions for the Europeanization of private law as a whole. The political will to fulfill all standards necessary for EU membership in Serbia is strong, including the full implementation of the *acquis communautaire.*

VI. Administration of Justice in the Post-codification Phase

1. National legal traditions and dispute settlement mechanisms

As early as the Middle Ages, Serbia had a developed, and even from today's standpoint, advanced judicial system. Several provisions from *Dušan's Code* from 1349 speak to this end. Firstly, judges were to adjudicate freely, according to the law, without fear of the imperial government.[37] Secondly, the Emperor stated that judges ought to adjudicate according to the law and justice even if he personally addresses them by letter requesting that someone, contrary to the law, be punished or pardoned.[38] Thirdly, it was stated that judgments had to be rendered in written form and in two copies, one of which stayed with the court and the other,

[37] See: article 172 of Dušan's Code.
[38] See: article 171 of Dušan's Code.

delivered to the party that won the dispute. These provisions indicate that there was a great sense of the necessity to provide for the rule of law and fair adjudication. Thanks to that, citizens resolved many disputes before the court. Naturally, there were many different models of alternative dispute resolution. These models became especially important during the Turkish occupation that lasted for several centuries. Circumstances did not change significantly until the 1830s. Life within the clan carried on in accordance with customary rules and decisions of the family elders. The elders held significant authority and a wide scope of power. Their decisions, to a great extent, influenced many issues concerning the every day life of the clansmen. The elders had an important role in relations with the outside world. Relations between different communities were ordered pursuant to customary law. Disputed issues were most often resolved by agreement between the disputing clans, in accordance with custom, mediated by third parties (friends, neighbors, etc.). Where a dispute could not be resolved, a decision was made by the Duke, based on custom and his own personal understanding of equity. Significant changes occurred after the Serbian Civil Code of 1844 was enacted, which sparked the disintegration of family clans. Already in the second half of 19th century the state played much more important role in the resolution of disputes. People started to go before the courts more frequently. In socialist Yugoslavia, many different forms of alternative dispute resolution were developed, such as "*mirovna veća*" – *justices of peace* (for disputes among natural persons), "*sudovi udruženog rada*" – *courts of joint labour* (for commercial and labour disputes), etc. However, the role of state courts has remained dominant up to the present. Despite many public critiques of the judiciary, people still resolve most of their disputes through the courts. In certain municipalities in the South of Serbia, litigation has become part of tradition, even a form of passion ("litigation for the sake of litigation"). Cases have been recorded in which disputes between families have transferred from generation to generation. In Serbia in the last several years, intensive work has been undertaken to implement some types of *mediation*. In commerce, for decades, a successful model of *dispute resolution through arbitration* has been applied.

2. Freedom of Contract, Customary Law and Trade Practice

Courts adjudicate on the basis of the Constitution, laws and other general acts. However, it should be kept in mind that the *Law on Contracts and Torts* from 1978 set a very wide *freedom to contract*, which provides for the possibility of diverging from optional provisions and to regulate mutual relations in accordance with individual needs.

In certain cases, the courts may adjudicate in accordance with the customary rules. Depending on whether they apply to all citizens or limited societal groupings, these are divided into *general* and *special* customs. A general custom, for example, is giving a wedding present, while a special custom is one that applies only within a certain profession, for example, among traders (*usages*; *un-codified good business customs,* etc.).

Usages are codified trade customs and behavior that are published by chambers, stock exchange markets and some other professional business associations. Traditionally, they were divided into general and special classifications.. The general usages are applicable to the economy as a whole and the special usages are applicable only to certain industries or sometimes to a particular type of goods or services. In Serbia there are *General Usages for Trade on Goods* introduced in 1954 by the *Principal State Arbitration*[39] and a considerable number of special usages.[40] Two articles of the Law on Contracts and Torts directly regulate the application of usages. The first is located in the segment dealing with basic principles and the other at the end of statutory text, together with the transitional and concluding provisions. The first provision states that "Trade practices shall be applicable to obligation relationships after the parties to the obligation relationship have stipulated such application, or after relevant circumstances imply such intent."[41] In order to understand the rule better, it should be read together with the second which provides that, "(1) A provision of the general or special usage by which the presumption is determined that the contracting parties have agreed to apply the usage, unless excluding them by contract, shall not apply after coming into force of the present Law. (2) The General Usage of Trade (Official Journal FNRJ, no. 15/1954) shall not apply after the coming into force of the current Law concerning the matters regulated by it. (3) If general or special usage or other trade practices and customs are contrary to the dispositive norms of the present Law, the provisions of the present Law shall apply, unless the parties have expressly stipulated the application of usage, or other trade practices and customs." Legal provisions cited are being interpreted dif-

---

[39] OJ FNRJ br. 16/1954.

[40] 1. Harbour Usages (OJ FNRJ 2/1951); 2. Special Usages on Particular Tobacco Sorts and Catagories (OJ FNRJ 38/1956; 3. Special Usages on Vegetable Trade (OJ FNRJ 25/1960); 4. Special Usages on Rice Trade (OJ FNRJ 25/1960); 5. Special Usages on Bean Trade (OJ FNRJ 25/1960); 6. Special Usages on Potato Trade (OJ FNRJ 25/1960); 7. Special Usages on Wheat Trade (OJ FNRJ 29/1960); 8. Special Usages on Stone, Marble, Granit Blocks and Tablets Trade (OJ SFRJ 9/1967); 9. Special Usages on Construction (OJ SFRJ 18/1977); 10. Special Usages on Retail Trade (OJ SFRJ 12/1978, isp.: 29/1978); 11. Special Usages on Catering (OJ SFRJ 69/1983); 12. Special Usages on Book Trade (OJ SFRJ 19/1984).

[41] Art. 1107 LCT.

ferently in theory and judicial practice. The current holding of the Supreme Court of Serbia on the application of usage rules is expressed in its decision from 1997. It provides as follows, "Special usages, as codified trade customs are applied when not in contradiction with imperative rules. They have primacy over dispositive regulations, if the parties have explicitly or tacitly agreed on their application. Special usages have primacy over general usages where they are mutually incompatible, by applying the general and special relations rule. For legal relations with no positive regulation, but with an adequate usage rule, the application of usages can always be based on the tacitly expressed will of the parties. *Parties in obligation relationships have a duty to behave in accordance with usages and other trade customs. However, their application can be excluded explicitly or tacitly, either fully or partially*."[42] (emphasis added). The Law on Contracts and Torts does not establish a unique pattern for the application of usages. There are some general rules that apply principally to all usages, and other rules that apply particularly to usages introduced prior to the Law on Contracts and Torts coming into force. *General rules on the application of usages***:** a) They can be applied to issues not regulated by the law, as well as to issues of a dispositive character; b) Usages contrary to imperative norms and current trade customs cannot be applied; c) Usages shall be applicable to obligation relations after the parties to the obligation relation have stipulated such application, or after the relevant circumstances imply such intent d) Usages cannot be applied against the will of the contracting parties, except in situations of lacunae and only if the court finds that the specific usage rule can be treated as a good business practice; otherwise, the court will not apply it, but will proceed pursuant to the general rules applicable for bridging of lacunae in civil law.

Special rules for the application of previously introduced usages: a) The provisions of general and special usages establishing the presumption that contracting parties accepted the application of usage rules if not excluded by contract ceases to be applicable b) Old usages, that are contrary to the dispositive norms of the Law on Contract and Torts are only applied if the contracting parties have explicitly agreed on their application; it is not sufficient that the relevant circumstances imply such intent.[43]

Non-codified socially useful and morality-based rules, valid in business practice are considered to be good business customs. Very often they arise spontaneously and in unwritten form. Besides this, they can occur in the written form (through contractual practice of business partakers). Their

---

[42] Judgment of the Supreme Court of Serbia, Prev. 765/96. of 11 January 1997, Collection of court decisions, vol. XXI, Belgrade, 1998, pp. 122–124.

[43] See with explanations: Dušan Nikolić, *O primeni opštih i posebnih uzansi*, Pravni život, 11/2000, pp. 367–374.

nature is thereby altered. Even then they differ from laws and other regulations, because they are not enacted by state authorities or from usages, and because they are not codified i.e. collected and published. Basically, it is possible to differentiate between two types of trade customs. Some of them are exclusively valid amongst business parties. Usually, they are called trade or commercial customs. The rest encompass relations that arise between entrepreneurs and citizens (buyers of goods and services and users). They are in direct connection with the norms of civil law and consumer protection regulations. Surprisingly enough, usages despite being codified, accessible to all and precisely defined customs, apply only if the parties agree on their application, while good business customs, the content and existence of which is yet to be established, apply as a result of the law itself. The reasons for this concept are practical in nature. Some business areas are more durable and can be regulated by the law and usages without fear that accepted solutions will quickly be outdated. On the other hand, there are some matters that should not be regulated firmly, because of their excessive need for flexibility that cannot be anticipated by even the most inventive legislator. Legal norms and codified customary rules emerge as a limitation. They constrain the development of economic activities. Nonetheless, this matter cannot remain unresolved due to its great importance. This is why a compromise was reached by way of the referral technique. Good business customs referred by the law are constantly changing in accordance with practical needs that oblige participants to a certain way of conduct, similar to legal norms. In this way, the so-called dynamic stability of the legal system is achieved. The regulatory system is in that respect, being constantly changed, while the law remains fixed for a long time.

3. How do Judges Apply Legal Transplants?

There are many legal transplants in Serbian private law. Therefore, it is difficult to give a general evaluation of their acceptance by the citizens and courts. Those well versed in the features of the legal system are aware that there are considerable differences. For example, it is well known that earlier implants are applied more often and to a greater extent. Apart from that, a distinction should be drawn between rules that have been taken over from European continental law and those that originated in Anglo-American law. The latter rules sometimes do not fit into the logic of the legal system, hence the courts and the citizens are reluctant to apply them, or sometimes even reject them. An example from intellectual property law offers a marked example of this practice.

In the middle of 1990s, a set of laws regulating intellectual property was adopted, whereby the *triple indemnity* (*triple damages*) was introduced

into the legal system of the FR of Yugoslavia.[44] In the chapter dealing with civil protection, there are provisions prescribing that in the event of damage caused with intent, compensation may be sought to an amount three times greater than the actual damage and lost profit.[45] This legal principle was taken over from Anglo-American law that provides for the possibility of the injured party to ask the toartfeasor to pay compensation which is multiple times greater that the actual damage suffered, provided that the tortuous act was done out of malice, desire to humiliate or mistreat the injured party, or as a result of violent act, etc. Sanctions for such acts are known as *punitive damages* (or: *exemplary damages*, *retributive damages*, *punitory damages*, *vindictive damages*). It is pointed out in legal writings that these damages are awarded not only to compensate the injured party but also to *punish the defendant*.[46] On the other hand, in Serbia, as well as in other countries of Continental Europe, damages are one of the types of civil sanction[47] aimed at restoring the position of the injured party to the state it was in prior to the time when damaging act took place.[48] According to the Law on Contracts and Torts from 1978 "While also taking into account the circumstances after the occurrence of damage, the court shall determine damages in the amount necessary to restore the material state of the person sustaining damage into the state it would have been without the damaging act or omission."[49] The concept of punitive (multiple) compensation did not find its place in practice of civil courts in Serbia, because the judges consider it to be a systematic mistake. Save for a couple of cases, such claims were not brought by injured parties either.

4. Relationship between Judges, Private Practice and Academia

Legal scholars and practitioners (judges, barristers and lawyers working for commercial companies) cooperate in different fields. They take part in mixed committees that prepare bills, they participate in public discussions

---

[44] These laws have been published in OJ of FRY, no. 11/1995.

[45] For more detail see: Dušan Nikolić, *Trostruka naknada štete u našem pravu*, Sudska praksa, 2/1997. Dušan Nikolić, *Punitive (exemplary) damages (Bünteto jellegü karterites),* Novotni kiado, Miskolc, 2005, pp. 192–202.

[46] For more detail see: Harry Street, *Principles of the Law of Damages*, London, 1962.

[47] For more detail on civil law sanctions see: Dušan Nikolić, *Građanskopravna sankcija* (geneza, evolucija i savremeni pojam), Novi Sad, p. 99. etc.

[48] This principle was introduced in Roman times, with Lex Aquilia de damno; Lex Aquiliana. For more detail on Aquilian's Act see: Bénédict Winiger, *La responsabilité aquilienne romaine – Damnum Iniuria Datum*, Genève, 1997; Bénédict Winiger, *La responsabilité aquilienne en droit commun – Damnum Culpa Datum*, Genève, Bâle, Munich, 2002.

[49] Art. 190 of the Law on Contracts and Torts.

on proposed laws, etc. *Kopaonik School of Natural Law*, a form of congress for Serbian lawyers, as well as other academic gatherings, contribute greatly to this cooperation.

Legal science is not formally a source of law. However the highest courts, in taking their authoritative legal positions, sometimes invoke the opinions of distinguished legal thinkers. On the other side, professors and assistants from the faculties of law use examples from practice. Legal practitioners are taking part in certain forms of practical legal education more and more often, such as practical classes in the courts, law offices, state and local government organs, etc. Many universities offer *legal clinics*[50] that are also a type of transplant taken from American legal education.

VII. An Example of a Problematic Transplant: Introduction of Family Endowments

1. Background and Introduction

Serbia has a long and rich tradition of endowments. From the very creation of the Serbian medieval state in the ninth century, members of ruling and noble families devoted segments of their property to the Church and the people. The hundreds of churches, monasteries and Church property (*metoh*) on the territory of Kosovo and Metohija and central Serbia, up to the Pannonian Plain, is evidence of this. Property has always been designated to serve the public interest. Occasionally, rulers and their families would withdraw from public life and continue their lives in monasteries which they built from their own resources. In doing so, the monastery founders (*ktitori*) joined the order of monks. They lived with other members of the brotherhood or sisterhood and devoted themselves to charitable, cultural and educational work. This form of endowment was maintained through the end of Turkish occupation. Serbian nobility continued to build churches and monasteries north of the Sava and Danube rivers. The numerous monasteries on Fruška Gora near Novi Sad, had particular cultural and educational importance.

Towards the end of the eighteenth and the beginning of the nineteenth century, a new, secular form of endowment was developed. Wealthy Serbian attorneys, merchants, and Austrian nobles of Serbian origin, donated their property to the people. Endowment funds were created to assist poor students, orphans, young farmers, tradesmen, writers, artists, scientists, etc.

---

[50] For example: Novi Sad Faculty of Law has *Environmental Legal Clinic (pravna klinika)* <www.ekologija.pf.ns.ac.yu>.

Matica Srpska Society, founded in 1826 in Pest (today: Budapest, Hungary), had a special role in the development of endowments. Its founders, the young doctoral student Jovan Hadžić[51], and the wealthy businessmen: Đorđe Stanković, Josif Milovuk, Jovan Demetrović, Gavrilo Bozitovac, Andrija Rozmirović and Petar Rajić, assessed that it was necessary to work in an organized fashion on bringing Serbs back into European circles following centuries of Turkish occupation. Matica's work was, from the very beginning, aimed at representing Serbian culture in Europe. On the other hand, it also focused on the education and Europeanization of the Serbian people. The Matica Srpska Society was an example to other Slavic nations. Its activities inspired the establishment of similar cultural and scientific associations in other parts of Europe[52]. The Matica Srpska Society administered ninety-seven endowment legacies, although this property was nationalized following World War II.[53]

During the nineteenth century, endowments blossomed in Serbia, which was gradually emancipating itself from Turkish occupation. A large number of endowments were created up to World War II. Evidence of this can be seen in the numerous impressive facilities in the center of Belgrade and other cities, which today carry the names of their donors. The largest number of endowment properties was endowed to the University of Belgrade. That property was also nationalized after World War II.

2. The Traditional Concept of Endowments

Endowments always had the same goal and purpose among the Serbian people. Property was designated for the benefit of others, at the expense of one's own interests and the interests of his or her family. Donors wanted to do something for which they would be remembered by the people. In Serbian, this stems from the very name of this legal institute. By establishing the endowment (*zadužbina*), the people were indebted (*zaduživati narod*) to the donor (*zadužbinar*). To indebt to him or herself and his or her family meant something completely different. Therefore, among the Serbian people,

---

[51] See in more detail: Slobodan Jovanović, *Jovan Hadžić*, in the book: *Političke i pravne rasprave*, Beograd, 1908 (updated edition: Belgrade, 1990).

[52] Based on Matica's example the following institutions were created: Czech Matica in 1831, Ilyrian Matica in 1842 (renamed Matica hrvatska (Croatian) in 1874); Matica Lužičkosrpska in 1847; Halych-Russian Matica in Lviv in 1848; Moravian Matica in 1849; Matica Dalmatinska (Dalmatian) in Zadar in 1861; Slovak Matica in 1863; Slovenian Matica in 1864; Matica Opava in 1877; Matica in the Teschen Princedom in 1898 (from which Silesian Matica came to be in 1968); Polish Matica in Lvov (1882); Educational Matica in the Teschen Princedom in 1885; Educational Matica in Warsaw in 1905; Bulgarian Matica in Constantinople in 1909 and the new Bulgarian Matica in 1989.

[53] See in detail: Živan Milisavac, *Matica srpska*, Novi Sad, 1965.

an endowment was traditionally understood to be a *public endowment* – serving everyone, not only the members of an individual family.

In Serbian civil law as well, it is undisputed that an endowment is a charitable institution which disposes of revenue from property the founder irrevocably designated for the achievement of certain goals that are beneficial to society.[54] A problem, however, arises when it becomes necessary to clear up some of these conceptual elements, such as clearly establishing what these socially beneficial goals are.

In literature, it is said that endowments are formed for the purpose of inducing and assisting scientific and artistic creation, various humanitarian goals such as providing social care and healthcare protection for poor persons, rewarding and funding students, etc. The societal benefit, however, cannot be determined based on the nature of the needs which will be fulfilled in this way. It is just as important who the user (destinater) of the resources will be or whom the endowment will serve. This aspect of endowments has not been specially regulated by active rules, nor has it been considered any more thoroughly in recent legal theory. Therefore, it remains unclear whether family endowments, which are mentioned in literature, can be established in Serbia.[55]

3. Family Endowments

a) Definition

Per definitionem, family endowments are established in the interest of the members of a single or multiple specified families.[56] They are used, for example, to cover the costs of schooling, to assist financially in certain situations, etc.[57] As they serve to fulfill the private goals of individuals, these forms of dedicated property are in theory classified into the category known as private endowments.[58]

Family endowments (*Familienstiftung*) are commonplace within the territories of the *Germanic legal system*. Their significance and deep roots are reflected by the fact that they were regulated even under old Prussian law and the fact that they have survived until today, despite the Nazi regime's desire to remove them from the legal system together with the family *fidei-*

---

[54] Andrija Gams, Ljiljana Đurović, *Uvod u građansko pravo,* Beograd 1994. p. 88. Vladimir V. Vodinelić in: Obren Stanković/Vladimir V. Vodinelić, *Uvod u građansko pravo,* Belgrade 1996, p. 81.

[55] See: Vodinelić (previous note), p. 82.

[56] See: *Staudingers Kommentar zum Biirgerlichen Gesetzbuch,* Berlin 1957, Vol. 1. p. 371; P. Rescigno, *Fondazione* (dir. civ.) – *Le fondazioni familiari,* in: *Encidopedia del diritto,* Giufre editore, 1989. Vol. XVII, p. 810 etc.

[57] Compare with: Vodinelić (*supra* note 54), p. 82.

[58] See in more detail: Verica Trstenjak, *Pravne osebe,* Ljubljana, 2003, p. 369. etc.

commissum.[59] Even though many consider them to be relics of the feudal system, family endowments, in that environment, will probably survive for a long time to come. Doctrine and case law offer a very simple explanation for this: that which is useful to the individual, in essence, must be useful to society as a whole ("a wealthy individual – wealthy society"). In other words, private goals, which family endowments serve, are indirectly classified under the common good.[60] Besides this, in societies with highly developed economies, a more permanent tying up of resources to one or more families does not bring the high living standard or the social stability of the state into question.[61]

In France, with along some other countries of the *Roman legal sphere*, the establishment of family endowments is not allowed. Certain theorists claim that this can be ascribed to the traditionally strong state structure that strove to impose control on the greatest number of social relations as possible, including the domain of private law, and especially relations that can influence the financial trends within a country. However, there are much deeper, historical reasons for the negative stance towards family endowments. It is well-known that the French Civil Code (*Code civil*) of 1804, originated from the French bourgeois revolution. One of the primary goals of the revolutionaries was to abolish the feudal order and to prevent its re-emergence. Private endowments and the various models of family *fidei-commissa* were unacceptable because they could be used as a tool to permanently maintain the feudal aristocracy's economic power and influence in society. Besides this, these legal institutes were contradictory to the liberal spirit of a civil society, which strove to subject societal resources to

---

[59] In May 1940, regulations aimed at abolishing family endowments were enacted. However, the deadline for the completion of this process was constantly extended. The federal law of Germany of 28 December 1950 permanently delayed the abolishment of this institute. See in more detail: *Staudingers Kommentar* (*supra* note 56), Vol. I, p. 371–372.

[60] An endowment, in the sense of this federal law, is based on the order of the founder a property permanently designated for the fulfillment of generally beneficial or merciful goals (...) The endowment's purpose is generally beneficial even when the endowment's activity benefits only a limited number of persons." (par. 2. Law on Endowments of Austria of 10 January 1975). See in that sense also: *Staudingers Kommentar* (*supra* note 56), p 380.

[61] For more detail on family endowments in countries of the Germanic legal sphere: Peter Breitschmid, Hans Michael Riemer, *Grundfragen der juristischen Person*, in: *Festschrift für Hans Michael Riemer zum 65. Geburtstag*, Bern, 2007; Christian Kirchhain, *Gemeinnützige Familienstiftung*, Frankfurt am Main, 2006; Ernst Marschner, *Optimierung der Familienstiftung: Aus der Sicht der Begünstigten,* Wien, 2006; Reinhold Lindner, Haas Bacher Scheuer, Gerhard Brandmüller: *Gewerbliche Stiftungen: Unternehmensträgerstiftung – Stiftung – Familienstiftung*, Berlin, 2004; Martin H. Sorg, *Die Familienstiftung,* Baden-Baden, 1984; Bruno B. Güggi, *Die Familienstiftung*, Vaduz, 1982.

market forces and to give everyone a chance to participate in their reallocation under equal conditions.[62]

As it was previously mentioned, Serbian civil law is traditionally tied to the Germanic legal sphere. Sufficient indicators of this are seen in the fact that the Serbian Civil Code of 1844 was drafted based on the Austrian Civil Code of 1811, as well as the implementation of Austrian law on the territory of southern part of Vojvodina, on the territory of the former *Vojna Krajina* (Military Border) as late as 1945.

However, private law in Serbia did not develop exclusively under Germanic influence. Many normative approaches were original, as well as some which were taken from the Roman legal sphere. So, for example, the Serbian Commercial Code of 1860 was drafted based on the French Commercial Code (*Code de commerce*). This turnaround was the result of Serbian lawyers being educated at French universities in the second half of the nineteenth and first half of the twentieth century.

The liberal ideas of French law undoubtedly also influenced the drafters of the Law on Endowments (*Zakon o zadužbinama*) of 1912. The Law contains a definition which, based on its structure, could serve as an example to the editors of many modern regulations. By following the rules of logic, the Law first states what endowments are, and then, what they are not *(definitio fiat per genus proximum et differentiam specificam).* So, according to the drafters, "charitable institutions, which are *limited to only one or more designated families, do not fall under the classification of endowments* [emphasis added]".[63]

The negative stance towards family endowments is a reflection of the liberal spirit in Serbia at the time and the desire of progressive social forces to remove the relics of the feudal order. A confirmation of this position can be seen in the fact that only a few years later, the family *fideicommissum*, which based on its function largely coincides with family endowments, was abolished.[64]

b) Prohibition of Family Fideicommissa

Through fideicommissary substitution, family property is placed outside the reach of legal transactions in order to secure the economic power of future generations for which heirs will be determined based on the principle of *primogeniture*, *seniorat* or *majorat*. This heir has a similar legal

---

[62] Compare: G. Marty, P. Raynaud, *Droit civil*, Tome I, *Introduction generale a l'etude du droit des institutions judiciaires, les personnes,* Paris, 1956, str. 1270; A. Trabucchi, *Instituzioni di diritto civile,* Padova 1960. p. 103.

[63] Art. 1, par. 2 Law on Endowments of the Kingdom of Serbia, 14 January 1912.

[64] On the functional congruence of these two institutes, *Staudingers Kommentar* (*supra* note 56), p. 371.

status to the beneficiary. He can manage the property (as a good host), reap profit and dispose of it, but cannot alienate the inherited property. He is obligated to maintain the estate intact for future generations. In this way, the family property is operates under what is known as *dead hand control* (*dobro mrtve ruke*). This 'deadening' of resources was contrary to the foundations of the social order of the Kingdom of Serbs, Croats and Slovenes, and so the family trust was abolished with the St. Vitus Day (Vidovdan) Constitution of 28 June 1921. In practice, however, many other unsolved problems remained in relation to this civil law institution. As a result, in 1934, the Law on the Disbanding of the Family *Fideicommissum* was enacted.[65]

Fideicommissa are also prohibited by active regulations. Pursuant to Serbia's Law on Inheritance, "any testamentary provision by which the testator designates an heir to his heir or his legatee, 'as well as any one' through which the testator prohibits the alienation of the property or any right left to him".[66] Analogously, the same should apply to family endowments which, in relation to their functions, coincide with *fideicommissa*. If not, the prohibition on *fideicommissa* would be meaningless. Family endowments could, moreover, serve the same purpose.

4. Preliminary Draft of Serbia's Law on Endowments and Foundations

In November 2007, the Ministry of Culture of the Republic of Serbia and the Balkan Fund for Local Initiatives (NGO) formed a working group for a Preliminary Draft Law on Endowments and Foundations. The project was completed in early June 2008. Subsequently, the Preliminary Draft was opened to public discussion during which the issue of family endowments was brought up.

a) Normative Approach

Pursuant to the Preliminary Draft: an endowment is "a legal person without any members, the founder of which designated certain property (principal property) for the charitable realization of public (universally beneficial) or *private interests and any purpose not prohibited by the Constitution and laws*[67] [emphasis added] "An endowment and foundation are established voluntarily and *they are independent in the determination of their purpose*[68] [emphasis added.]"; "An endowment and foundation are

---

[65] Law published in "Official Papers" No. 164/1934.

[66] Art. 159, pars. 1 and 2 Law on Inheritance (Official Gazette of the Republic of Serbia No. 46/1995).

[67] Art. 2, par. 1.

[68] Art. 5.

established for an *indefinite* or definite time period. In case of irremovable doubt, *the endowment will be considered to have been established for an indefinite period of time.*[69] [emphasis added.]"; "The minimal value of principal property necessary for the establishment of an endowment which functions for the *public interest is 50,000 Euro*. The minimal value principal property necessary for the establishment of an endowment which functions *for private interests is 100,000 Euro* [emphasis added].

b) Explanation of the Normative Approach

The explanatory note states that the acting Law on Endowments, Foundations and Funds of 1989 does not represent an adequate legal framework for the development of endowments because, among other things, it only enables the establishment of endowments for public good and not for private goals. The approach adopted by the authors of the Preliminary Draft, "has been adopted in a large number of EU countries and can be defended with *in extenso interpretation of the right to peaceful enjoyment of possessions*, a right which is protected by the European Convention on Human Rights and Fundamental Freedoms [emphasis added]. In addition to this, the authors emphasize that more stringent conditions are provided for the establishment of private endowments (a greater minimal value for the principal property).

c) A Critique of the Proposed Approach

There are a number of reasons why it is necessary to re-evaluate the idea of introducing private and, particularly, family endowments into the legal system of the Republic of Serbia. Some of these reasons are principled in nature and relate to the historical heritage and internal logic of the legal system, while others are specific and have to do with many of the legal, economic and social issues important in the daily life of citizens. In the spirit of European legal tradition, they should be addressed starting with the general to the specific:

1. With the creation of family endowments, a segment of social (national) resources is placed under *dead hand* control.
2. These resources are not subject to market forces.
3. The removal of endowment property from the total resources in the market, directly or indirectly, slows down the economic development of society, regardless of whether this is happening in a developed of undeveloped country.

[69] Art. 9, pars. 1 and 2.

4. This problem is even greater in poor societies in transition, in which there is a high degree of social inequality.
5. If a small number of incredibly wealthy families were to establish family endowments, the majority of resources in countries undergoing transition would be under dead hand control.
6. The establishment of family endowments would permanently fix the economic and social power of all current and future members of certain families.
7. Societal relationships could be preserved as they are.
8. It would prevent the establishment of a middle class, which is necessary for societal stability.
9. The majority of citizens, particularly younger generations, would lose the perspective and confidence in social institutions which have so far, at least formally, enabled everyone to participate in the reallocation of social resources.
10. If the largest part of social resources was transformed into endowment property under the exclusive control of individual families, there would be proportionately fewer resources available for the establishment of public endowments.
11. In the spirit of development of a civil society, public endowments should in the future take care of many public interests currently under state control.
12. If states do not have sufficient funds in their respective budgets and public endowments are not established in the meantime, the overall development of certain societies undergoing transition and the livelihood of many of their citizens could be brought into question.
13. As a result, certain regions could become unstable in the long run.
14. The establishment of family endowments in countries undergoing transition could therefore, indirectly, negatively influence the dynamics and effects of integrative processes, which are expected to enable the linking of societies with different legal cultures, and the development of civil society.
15. Family endowments are not part of the Serbian tradition, in neither a cultural nor a legal sense.
16. In accordance with the principles of Serbian endowment law, the endowment property should serve the fulfillment of public interests.
17. The Serbian legal system has held a negative stance towards *fideicommissa* and similar legal institutes, which include family endowments for over a century.

18. Serbia is facing economic and social problems which accompany transition, including a high level of social inequality and the lack of a middle class.
19. State public interest funds are quite modest, while the spirit of traditional Serbian endowment law has not been rekindled.
20. Under such circumstances, the liberal stance towards the establishment of family endowments which was manifested in the Preliminary Draft with the statement that anything which is not prohibited by the Constitution or the laws is allowed, simply does not correspond to the reality and perspectives of the society in which the citizens of Serbia live.
21. The stance that "endowments are independent in the determination of their purpose" is fully in accordance with the concept of endowment law, but it has a significantly different meaning with respect to the function of private endowments.
22. Even at first glance, one cannot avoid the impression that the Preliminary Draft was written for the benefit of the wealthy strata within society. The text provides that endowments can be established for an indefinite or definite period of time, immediately followed by a statement that in case of irremovable doubt, *the endowment will be considered to have been established for an indefinite period of time.* Interestingly, the minimal amount for the establishment of a family endowment is *twice the amount* required for a public endowment, and is calculated at 100,000 Euro, which is an incredibly large amount for most citizens. Therefore, one can conclude that the establishment of family endowments would be a privilege for only some wealthy members of society. The inheritance of poor families would remain subject to legal transactions which means that it could be subject to further reallocation of societal resources.
23. The draftsmen themselves concluded that private (family) endowments do not exist in all European Union countries and that their establishment could (only) be defended through *in extenso*, i.e., an extensive interpretation of the right to the peaceful enjoyment of possessions, protected by the European Convention of Human Rights and Fundamental Freedoms.
24. The creation of a normative template for the establishment of family endowments is not a requirement for European Union membership.
25. Serbia could more efficiently respond to the challenges of globalization, civil society and current world economy crisis by keeping only the traditional concept of (public) endowments, while stimulating their development at the same time.

D. Company Law in Eastern Europe

The Serbian Law on Commercial Companies

MIRKO VASILJEVIĆ

In this paper, the author presents the basic institutes of company law of Serbia according to the solutions provided by the Law on Commercial Companies (2004), as the primary source, and the solutions of other secondary sources of law. An overview is given of the fundamental solutions of these sources, the structure and character of regulations pertaining to commercial companies, the roles of comparative law on the change in character of the regulations and codification, the "Europeanization" of the national company regulations, as well as a review of legal transplants. The author gives a retrospective view of specific issues relating to company

law: the relevance of the corporate governance code, relationship between directors-shareholders (especially the responsibilities of the director, conflict of interest and business judgment rule), special rights of minority shareholders, the relations between the national company law and the securities market and the efficiency of national agencies for judgment enforcement. Finally, an overview is given of the state of the judiciary following the new codification (national legal tradition and mechanisms for the resolution of conflicts; judges' positivistic or a new approach of regulated statuses; courts and the freedom of contract; the implementation of legal transplants by judges, relations between judges, theory and practice).

I. Quick glance at Company Law Regulations

Commercial companies in Serbia are regulated by a single act – the Law on Commercial Companies.[1] With this law (primary source of law) the following commercial companies are encompassed: general partnership (Articles 53–89), limited partnership (Articles 90–103), limited liability company (Articles 104–183), joint stock company (Articles 184–346). Aside from these four forms of commercial companies the laws of Serbia do not recognize any other legal forms of commercial companies. The Company Law of Serbia, in addition to these forms of commercial companies, also regulates the sole proprietorship (tradesman) – Articles 48–52. The Company Law of Serbia contains "Basic Provisions" which in essence pertain to all commercial companies – Articles 1–47 (basic principles, formation, registration and publication of registration, liability of founders and other persons, registered office and registered name, representatives and agents, persons owing a duty to a company, direct and derivative action, information, publication and period of limitation); as well as provisions on: the liquidation of business companies (Articles 347–365); affiliations of companies (Articles 366–376); reorganization of companies (Articles 347–365); change of the legal form of companies (Articles 426–441); acquisition and disposal of high-value assets (Articles 442–443); special rights of dissenting shareholders and members (Articles 444–449), penal provisions (Articles 450–451) and transitional and final provisions (Articles 452–457).

In addition to this primary source of law, important sources of law for the status of commercial companies are also the following secondary sources: The Law on the Registration of Businesses[2], The Law on the Se-

[1] Published in the "Official Gazette of the Republic of Serbia", No. 125/04.

[2] Published in the "Official Gazette of the Republic of Serbia", Nos. 55/04 and 61/05.

curities Market and other Financial Instruments[3], The Law on Banks[4], The Insurance Law[5], The Law on Investment Funds[6], The Law on the Takeover of Joint Stock Companies[7], The Bankruptcy Law[8], The Law on Bankruptcy and Liquidation of Banks and Insurance Companies[9], The Law on Accounting and Auditing[10], The Law on Contracts and Torts.[11]

II. The Idea and the Codification Process

1. The Structure and Character of Regulations on Commercial Companies

The regulation on commercial companies (in the classical sense both partnerships and corporations) in Serbia, according to the aforementioned, is therefore unique and governed by one law. The Law on Commercial Companies of Serbia has opted for the legal organization of classical forms of commercial companies (general partnership, limited partnership – usually, a limited liability company and joint stock company), which are, as a rule, regulated in the legislatures of developed countries and in the legislatures of transitional countries. All forms of commercial companies are registered in the register of commercial entities (businesses) that is managed by a special Serbian Business Registers Agency, which was founded by a separate law.[12] All forms of commercial companies have the status of a legal entity that they acquire by registering. The choice of a legal form of commercial company can be made freely and depends on the will of the founder (the general and limited partnerships do not have a minimal basic contribution in currency defined by law; limited liability company has a mandatory minimum capital of 500 Euros in the equivalent value in Serbian Dinars (RSD) – 50% of this amount is paid before the registration and 50% within a two year period from registration; closed joint stock companies have a regulated minimum capital of 10,000 Euros of equivalent value in Serbian Dinars, and open joint stock companies have a 25,000 Euros of

---

[3] Published in the "Official Gazette of the Republic of Serbia", No. 47/06.

[4] Published in the "Official Gazette of the Republic of Serbia", No. 107/05.

[5] Published in the "Official Gazette of the Republic of Serbia", Nos. 55/04, 70/04 and 61/05.

[6] Published in the "Official Gazette of the Republic of Serbia", No. 46/06.

[7] Published in the "Official Gazette of the Republic of Serbia", No. 46/06.

[8] Published in the "Official Gazette of the Republic of Serbia", No. 84/04.

[9] Published in the "Official Gazette of the Republic of Serbia", No. 61/05.

[10] Published in the "Official Gazette of the Republic of Serbia", No. 46/06.

[11] Published in the "Official Herald of the SFRY", No. 29/76 and the Official Herald of the SFY, No. 31/93.

[12] Law on the Serbian Business Registers Agency – published in the: "Official Gazette of the Republic of Serbia", Nos. 55/04 and 61/05.

equivalent value in Serbian Dinars – in both cases, the system of payment is the same as with the limited liability companies). Exceptionally, the special laws regulating certain activities limit the possibility of choice to only some forms of commercial companies (e.g. activities within the financial sector can be performed in the form of a joint stock company, or rarely, for some activities, also in the form of a limited liability company, while some activities of free professions can only be performed in the classical form of a partnership – e.g. the practice of law in the form of a general partnership).

As for the character of the regulations on commercial companies, especially with regard to the Law on Commercial Companies, it can be said that, in essence, the default solutions expressed with the formula "unless otherwise specified by the founding act or articles of partnership" dominate in the area of classical forms of partnerships (general or limited partnership). This is further emphasized by the existence of the principle of party autonomy in regulation of the relationship between the partners or between a partner and the company. Exceptionally, even with these forms of commercial companies, the Law contains certain mandatory rules that cannot be derogated from. These are contained in the section regarding the protection of the interest of third parties: the statutory joint and several liability of the partners within the company for the obligations of the company towards third parties extending to their personal property, the duty of registration, the duty of having a founding act with the minimum of the prescribed essential elements, the pre-emptive right in acquiring of a partner's stake, minimum number of partners. In essence this also applies to the limited liability company and closed joint stock company, except that here, mandatory statutory norms apply to: minimal legal capital, liability toward third parties with properties of the company and personal properties of the members and shareholders in the event of the existence of the precondition for the utilization of the institute of "piercing the corporate veil" the existence of the representatives of a company and the entry into the register, minimum number of members and shareholders (can be one), maximum number of members and shareholders, the principle "one stake – one member" and "one share – one vote", the existence of bodies of company, the existence of the register of stakes and a Central Register of Securities founded by the law and holding and preserving the acts and documents of the company. Finally, with regard to the open joint stock company, the rule that the default statutory norms prevail over mandatory norms reverses to the rule that mandatory statutory norms prevail and default norms apply as an exception. This applies to both the Law on Commercial Companies, that regulates the foundations of this company

and the Law on the Securities Market and other Financial Instruments that regulates the dynamics of this type of company (emission of securities and competences of the Serbian Securities Commission as the regulatory body of the financial market founded by this law).

2. The Influence of the Free Market after 1990 on the Reform of Company Law

Until 1990 in Serbia and the former Yugoslavia, the so-called social property had a property monopoly i.e. dominated in the market. However, public property (the public sector of the economy) also existed, and in part, private property (agriculture, handicrafts, tourism and some other services). One year earlier, (1989) the Law on Social Capital was passed at the level of the country (Yugoslavia), (thus initializing the privatization process) and the Law on Enterprises took effect (such a law was enacted for the first time following the Second World War and regulating the legal forms of commercial companies). With the war activities on the territory of the former Yugoslavia, the privatization processes and the foundation of commercial companies with private and mixed ownership ceased, and following the "break-up" of the country and the formation of new states, every state had initiated the process of privatization in their own manner, by passing new laws.

In any case, Serbia like the other republics of the former Yugoslavia, due to the existence of private properties in certain economics sectors had some market experience and private initiative, including legal institutes of market economy (property, guaranty, credit, securities, contracts, etc.). War activities significantly slowed down the development of the market and processes of privatization up to 1995, whereas in Serbia this was further extended until 2000, following the notorious events relating to the Autonomous Province of Kosovo and Metohija and the changeover of the political regime. Finally, several Laws on Privatization ensued, which introduced the process of economic democratization simultaneously with the process of political democratization. When the privatization of socially owned property, along with the legal forms of so-called socially-owned companies, which were based upon it, made significant headway, the enactment of the Law on Commercial Companies (2004) ensued, which in a modern way regulates the legal forms of commercial companies (with a total of 457 articles). The formal deadline for the privatization of socially owned companies expired at the end of 2008, although there remained close to 800 of those companies that have not been privatized up to that point. Hence, the privatization process was initiated for all of them pre-

cisely at that time (tenders, auctions, bankruptcies and reorganizations).[13] The privatization process, for the greater part, still does not encompass the so-called publicly owned companies (companies owned by the state or a local community), which possess approximately 1/3 of the economic resources and for which there are no formal legal deadlines for their privatization. The same applies to state institutions in the domain of culture, health, education, sport and so forth.

3. Codification after 1990 and the Role of Comparative Law

The first significant legal document created after 1990 in the field of company law is the Law on Enterprises (1996), which applied to the territory of the Federal Republic of Yugoslavia (Serbia and Montenegro). It was the first significant legal document for the regulation of the foundations of commercial companies, containing 438 out of 450 articles dealing with the legal forms of commercial companies (only 12 articles were dedicated to the so-called socially and publicly owned companies). This was a major improvement, in comparison to the previous Law on Enterprises, (which came into force 1 January 1989) that contained only 19 articles dealing with commercial companies. The Law on Enterprises of 1996 represented a successful legal document of its time, founded on the best models of comparative law of that period, and which, to a great extent, "survived" in the Law on Commercial Companies of Serbia of 2004.

The Law on Commercial Companies of 2004 represents a modern legal document, based to a great extent on the tradition of the comparative continental company law, with the adoption of numerous new legal institutes of Anglo-Saxon company law, which are increasingly accepted, either through sources of company law of the EU or through national company laws, even in the company legal regulation of the continental Europe. A large number of new legal institutes of company law have been adopted by this law, including, *inter alia*: single foundation act required for entry into the registry, freedom of choice of a business name including partnerships, short deadlines for registration into the business register, assessment of

[13] The statistics of privatization and ownership relations is at this time as follows: 1) number of sold companies (total: 1796): with a 100% socially owned property 1128, which makes 63%; companies that are in their majority socially owned 454, which makes 25%; state companies 151, making it 8%; the remaining 63, makes 4%; 2) number of unsold companies with a registered property structure (total: 293): with 100% socially owned property 155, making it 53%; companies that are in majority socially owned 58, making it 20%; state companies 51, making it 17%; the remaining companies 29, making it 10%; 3) number of unsold companies for which the property structure had not been registered is 464; 4) a total of 388 annulled contracts on the sales of privatized companies, making it 20% of all sold companies.

contribution in kind in closed forms of companies by the founders themselves, reducing the statutory minimum capital amount in companies with limited liability, flexibility in the organization of corporate bodies in closed forms of companies, transparency of affairs in companies and their capital, strengthening of the rights of the minority shareholders, independent directors and independent committees, the conflict of interest clause and the competition clause, business judgment rule, cumulative voting for the election of the members of the governing board, convening the assembly of the joint stock company by the court in a regulated short time, disposal with the property of great value, dematerialization of serial securities, etc.

An important legal document for the operation of commercial companies in Serbia is also the Law on Contracts and Torts, which was inherited from the old Yugoslavia (1978, 1993, 2003) and contains complete contractual regulations based on the model of unitary regulations (civil and company law contracts governed by the same act). This law is based on the Draft for the Law on Obligations and Contracts, whose author was one of the leading professors of the University of Belgrade Faculty of Law – Prof. Mihailo Konstantinovic,[14] who as a French scholar had to a great extent transferred the legal culture of the French Code Civil (1804) and the Swiss Civil Law Code (1911). The value of this legal document is supported by the fact that it was adopted, with insignificant changes, by all other Yugoslav republics, now independent states, when passing their own laws from this area.

4. The influence of the EU Law – did the membership or the prospect of membership in the EU contribute to the "Europeanization" of the national company regulative?

The Government of the Republic on Serbia had adopted the *first Action Plan for the Approximation of Domestic laws with the Acquis Communautaire* in 2003, including the laws from the domain of company law. Later on, the Statement on the Approximation of Draft Laws, Other Regulations and General Legal Acts with the *Acquis Communautaire* was introduced into the legislative procedure. In the following year, 2004, the National Assembly of the Republic of Serbia had adopted the Resolution on the EU Association. Still, the legal obligation to harmonize local regulations with those of the EU arose only with the signing of the Agreement on the Stabilization and Association of Serbia to the EU, which was signed

[14] M. Konstantinovic, Skica za Zakonik o obligacijama i ugovorima (*Draft for the Law on Obligations and Contracts*), Belgrade, 1969.

as an international document on 29 April 2008.[15] The two most important obligations that Serbia undertakes with this document are the establishment of a free-trade zone (within the period specified in the agreement) and the harmonization of the legislation of the Republic of Serbia with the EU law (within the time period specified in the agreement). With this act, the following areas have been identified as priority areas that have a direct influence on the creation of the free-trade zone between Serbia and the EU: protection of competition, control of state aid (subsidies), intellectual property law, public procurement, standardization and consumer protection.

The perspective of the EU membership and especially the obligation undertaken to harmonize the domestic legislature with the EU legislature contributes to the "Europeanization" of the company regulations in Serbia. The current Law on Commercial Companies has to a great extent adopted the principles and standards of the company regulations of the EU, and often the concrete solutions as well. Bearing in mind that even the company regulations of EU are undergoing changes (for examples changes to the Third, Sixth and Tenth directives have been proposed, and the recent changes to the First and Second directives), and that the High Level Expert Group to the EU Commission for the reform of the Company law in their Report (2002) had projected the changes to the company regulations of the EU for the short, medium and long term time period, that the national company regulative of the EU member states has been undergoing significant changes in recent years, it would seem that the company regulations of Serbia do not fall behind these trends and that the country is acting responsibly and professionally. On the agenda of the Government of the Republic of Serbia, amongst other things, is the new Law on the Protection of Competition, the new Law on Consumer Protection, the new Law on State Aid to Companies, and the new Law on Standardization. The new Law on Public Procurement has already been enacted, while changes and amendments to the Law on Commercial Companies and the intellectual property laws are underway. The Government of the Republic of Serbia also formed a team of experts two years ago for the preparation of the Civil Code of Serbia (that would include provision on commercial contracts).

5. Legal transplants

It is logical to conclude that the Company Law of Serbia which is based on the Law on Commercial Companies (2004), as a law regulating the position of capital in the economy, as a legal instrument based on private and state owned property (and the property of local communities), cannot

[15] Ratification of the National Assembly published in: The Official Gazette of the Republic of Serbia, No. 83/08.

be an original law. Rather, such a law attempts to organize the forms of entrepreneurial activities on the basis found in the comparative law of the developed countries. Therefore, Serbian Company Law is dominated by legal transplants of well-known legal institutes regulated in the company laws of the EU and partially of the USA. Borrowing legal institutes of foreign company laws represents the major method of the development of company law in transitional countries, including Serbia, and not the creation of an original law. That process is led by the legal elite, whose degree of legal culture and the quality of legal education, that is the knowledge or lack thereof of comparative company law, influences the overall law reform, and especially the reform of the company law. In fact, it seems that special contribution of the local legal culture should be in the selection of systems and institutions that are suitable for legal transplantation (borrowing, reception) and not in creation of original solutions. A serious question remains regarding the relationship between the law and the special character of a society (local legal culture and "the spirit of the nation").[16] However, it is questionable how effectively powerful the legal elites of small countries are in influencing the choice of the system from which the borrowing takes place (the offensive of Anglo Saxon law is evident), without denying the need for the borrowing, as well as the election of corresponding institutes from that system and validation of the need of the influence of the "spirit of the people" and the local tradition and culture.

The borrowing and harmonizing of legal institutes in the area of company law is certainly a desirable process. Small countries have special needs due to the lack of their own legal capabilities and underdeveloped local law, as well as the need to recognize identical institutes by the owners of the capital that are coming from developed countries and developed laws. Whilst not overestimating the influence of the specific nature of societies and the "spirit of the nation", it would seem that that influence should not be completely neglected for it could occur that the borrowed institute gets to be discarded just like an organism discards a "foreign body" that is not accepted after a transplantation. A certain risk for the success of the transplanted institute is also carried by its modification during the transplantation, which is often the case, irrespective of whether this is due to a lack of understanding or to the need for "originality". Thus, for example, the institute of one term mandates of the directors of open

[16] It is the borrowing and durability of the transplants which reassure Prof. A. Watson of the fact that there is no simple relation between society and its laws, and that that relation can be least of all explained by the "spirit of the nation". *See:* A. Watson, *Legal Transplants – An Approach to Comparative Law*, Belgrade, 2000, pp. 41–52 and 143–151.

joint stock companies, taken over by the Serbian company law from the Anglo-Saxon practice, has a slim chance of long-term survival. The same applies to numerous other institutions or legal standards perfectly acceptable under Anglo-Saxon practice and tradition, but ill-equipped to promote legal certainty in different legal and social surrounding (e.g. "reasonable belief", "the best interest of commercial companies", derivative action, independent directors, assembly of the joint stock company at the court order, cumulative vote, etc.).

III. Specific Legal Issues of the Company Law

1. The Relevance of the Corporate Governance Code

The Law on Commercial Companies of Serbia recognizes the institute "the Code of Conduct" (the corporate governance code), as an autonomous source of law.[17] The Law requires enactment of such code in every listed joint stock company, whereas the company itself can adopt it or choose some other code (which is usually done by selecting the OECD Principles of Corporate Governance[18] or by choosing the national Corporate Governance Code).[19]

The Code contains the rules pertaining to the assembly of a joint stock company (rights of the shareholders, convening the meeting of the assembly, right to vote, voting in absence, voting by mail, voting through authorized person, contracts on voting, cross-boarder voting, manner of voting, quorum and the deciding majority, voting commission, conference calls, institutional shareholders), rules on the board of directors (tasks and obligations, defensive measures in the event of a takeover procedure, executive and non-executive members, independent members, president of the board of directors, election and dismissal, informing the members, assemblies, decision making, work evaluation, committee to the board of directors – for the appointment, for remuneration and revision, remuneration of members, conflict of interest), rules on supervisory organs and bodies (tasks and obligations, types of organs and the structure, election and dismissal, informing thereof, remuneration, *modus operandi* of the collective supervisory organ, conflict of interest), and the rules on informing the public (web site of the company, reports on corporate governance, financial reports), revision of financial reports and rules on sanctions if the code is violated.

---

[17] Law on Commercial Companies, Article 318.

[18] OECD Principles of Corporate Governance (1998, 2004).

[19] Published in: The Official Gazette of the Republic of Serbia, No.1/06.

The Corporate Governance Code of the Chamber of Commerce of Serbia contains three types of rules: 1) statutory rules, 2) recommendations or the so called "apply or explain" rules, meaning that if they are not accepted in a certain company, the company must provide an explanation, that is, justifiable reasons for the deviation, and 3) suggestions, that the company does not have to accept nor to provide an explanation for any exceptions from that rule, and which are regarded as a desirable corporate practice of listed joint stock companies.

Along with the Corporate Governance Code of the Chamber of Commerce of Serbia, in Serbia there is another national code, an identical Code adopted by the Belgrade Stock Exchange in July 2008, to be applied by listed companies which subscribe to it by way of a statement. The existence of multiple national codes in one country can only advance the corporate practice and contribute to more efficient resolution of agency problems relating to corporate governance (the same practice exists in the leading European countries).

The adopted Corporate Governance Code is published on the web site of the joint stock company and must be made available in a written form to any shareholder who requests it. The Board of Directors of the joint stock company submits a report at every annual assembly regarding the adherence of behavior with the code and any derogation from it, which can be a sufficient basis for the possible consolidation of its status liability within the company and the external responsibility to the company's shareholders.[20]

2. Director-Shareholder Relations (especially the duties of the director, conflict of interest, business judgment rule)

The Law on Commercial Companies of Serbia regulates the relations between directors and shareholders of a company (the so-called first agency problem of corporate governance, where the directors have the position of an agent, and the shareholders a position of a principal) through a set of rules pertaining to the duties of a director and the rules on the responsibilities of the director caused by the breach of the established duties. In this sense, there is a noticeable trend in the acceptance of Anglo-Saxon company regulations. In that way, basically there are three types of obligations established: The Fiduciary Duty, The Duty of Loyalty, and the Duty of Care.

---

[20] More: M. Vasiljevic, *Commentary on the Law on Commercial Companies*, The Official Gazette, 2006, pp. 614–615; Z. Arsic, "Corporate Governance Code", Law and Economy (PiP), Nos. 5–8/05, pp. 73–91; D. Vujisic, "Corporate Governance Code", PiP, Nos. 5–8/08, pp. 194–202.

The Law on Commercial Companies of Serbia, utilizing the standards of the Anglo-Saxon law as a starting point (legal transplant),[21] establishes the duty of a company director to work "in the best interest of the company" (The Fiduciary Duty).[22] Before this legal transplant was introduced, the legal practice of Serbia, as well as the practice in other countries of continental legal tradition, recognized only the standard of "good faith", as well as the standard of "due care of a good businessman". By observing this standard directors are now required "to execute their duties conscientiously, with the due care of a good businessman, with the reasonable conviction that they are acting in the best interest to the commercial company". Therefore, as a legal standard, the fiduciary duty of the director[23] requires stronger standards of observance than those imposed by an obligation emanating from the principles of good faith. In the USA, the courts and legal authors are unanimous that the directors need to subject their personal interests to the obligations owed towards the corporation, regardless of the origin of a potential conflict. However, there is still no agreement in case law whether there is a fiduciary duty solely towards the corporation.[24] In some cases, the USA courts acknowledge the fiduciary relationship between the director and individual shareholders. English judicial practice considers, however, that the member of the board of directors has

[21] According to the long tradition of English law, the directors have a fiduciary duty towards the company especially to work in a conscientious manner in the interest of the company, and not towards the individual shareholders – A. Hicks, S.H. Goo, *Company Law*, Oxford, 2004, pp. 310–325; E. Ferran, *Company Law and Corporate Finance,* Oxford, 1999, pp. 154–170. Still, in recent court decisions and theoretical standpoints, this attitude is questioned. See: H. Fleischer, "The Responsibility of the Management and of the Board and Its Enforcement" in: G. Ferrarini, K. Hopt, J. Winter, E. Wymeersch (eds.), *Reforming Company Law in Europe*, Oxford, 2004, pp. 373–375. On the other hand, certain authors are discussing the growing judicial practice of the American courts on non-company fiduciary duty of the director and the enlargement of the "corporate constituents" status. See: J. Choper, J. Coffee, R. Gilson, *Cases and Materials on Corporations*, New York, 2000, pp. 35–54.

[22] Law on Commercial Companies, Article 32, paragraph 1. On the term "company interest" see: D. Schmidt, *Les conflicts d intéréts dans la société anonyme,* Paris, 1999, pp. 7–25.

[23] More: B. Kasolowsky, *Fiduciary Duties in Company Law,* Hamburg, 2002, pp. 65–80.

[24] More: I.M. Millstein, H.J. Gregory, A.R. Altschuler, "Fiduciary Duties Under US Law", in: ABA – Section of Business Law – The Director's Relationship to the Corporation – A Multijurisdictional Forum on Fiduciary Duties, presented by: Committee on Corporate Governance and Committee on Corporate Laws, 2004, pp. 14–18; C. Hansell, D.W. Phillips, "Fiduciary Duties of Canadian Directors", in: ABA – Section of Business Law – The Director's Relationship to the Corporation – A Multi-jurisdictional Forum on Fiduciary Duties, presented by: Committee on Corporate Governance and Committee on Corporate Laws, 2004, pp. 3–4.

a fiduciary duty towards the company only when he is deciding or acting in that capacity, but not when he votes in an assembly in the capacity as a shareholder.[25]

The Law on Commercial Companies of Serbia, in accordance with the standards of Anglo-Saxon practice, specifies the cases where the fiduciary duty of the director is violated: 1) seizing the company's property (The No Profit Rule) – the property theory – ban on unjust enrichment (using the company property for personal interest, using privileged information in a commercial company for personal enrichment, abuse of position in the commercial company for personal enrichment), 2) using corporate opportunities – possibilities to his/her own advantage, 3) indirect advantages – linked persons (equality in all cases with bans in direct advantages), 4) non-competition of the director to the company in which he/she performs that function[26] and 5) conflict of interest with the company where he/she performs that function (The No Conflict Rule).

The Law on Commercial Companies of Serbia acknowledges the institute of the conflict of interests' clause, as a specific form of fiduciary duty of the directors towards the company where they perform that duty. A general standard of the company law regarding the fiduciary duty of the directors, instructs the directors to avoid all cases where they can find themselves in a potential situation where there exists a conflict of interests (personal or interests of associated persons) with the interest of the company towards which they have the fiduciary duty of work in its interest and that when there is such a conflict they remain loyal to the company (The Duty of Loyalty). Therefore, in all cases of performing the duties of a director, when there is a conflict of interest of the directors (personal or associated persons) with the interest of the company, the first rule that commands a general standard of fiduciary duty of the director towards the company is the disclosure to the competent body "of all material facts" with respect to this interest (unless they were known to him from the start), in order to approve the activity in question. In the case of a commercial company, the competent body is the Board of Directors (which decides with a majority of votes of the members, who do not have any interest in the given affair, and if that majority does not exist, then the majority of votes of shareholders of the assembly of the company decide who do not have any interests in the given affair). If a decision of the governing board is tainted by a conflict of interest, then in relation to that very approval, the Serbian Law on Commercial Companies requires that the assembly of the commercial

---

[25] Case: Northern Counties Securities Ltd. v. Jackson & Steeple Ltd. [1974 2 All ER 625] (Chancery Division), in: L. Sealy/S. Worthington, *Cases and Materials in Company Law,* Oxford (8th ed., 2008), p. 199 et seq.

[26] Law on Commercial Companies, Article 33–34 and 37.

company be notified at the first meeting thereafter. Finally, according to this law, a legal transaction in which there exists a conflict of interest of the directors (or associated persons) with the company in which they execute that function, becomes legally valid once having received this approval from the competent body, or if it is proven that the transaction is in the interest of the commercial company "at the time of conclusion or the time of performance". Otherwise it is nil and void.[27]

Finally, the Law on Commercial Companies of Serbia established the Duty of Care of the directors as a special standard, regulating the duty of the directors to "perform their duties conscientiously, with due care of a good businessman". The Law states precisely that adherence to this standard is deemed to exist if all the business decisions of the directors are "based on the information and opinions given by persons who are experts in the field involved, whom they believe to be scrupulous and competent in that respect".[28] The duty of care is the same as what the civilists are calling "the obligation of care", which implies the duty of engaging all sources in one's power for the purpose of achieving a certain result (aleatory). Therefore, the members of the Board of Directors cannot guarantee the achievement of a certain result (obligation of result), but will exercise "due care" within the ambit their powers (obligation of means), according to an abstract standard of a "reasonable man", or a "good businessman".[29] The difficulties in assessing "due care" derive from the fact that there are no objective criteria for evaluation in the domain of corporate governance, which is further complicated by the fact that there are different categories of directors: directors by right and factual directors, executive and non-executive directors, internal and external directors, independent directors and directors that do not have interests in a certain affair, directors and administrators (*officers, administrateurs*), directors present and absent at the assembly of the board, "so-called directors" or "figurehead directors" and so forth.

The Law on Contracts and Torts of Serbia also acknowledges the "duty of care of a good businessman" or the "due care of a good expert" standards. According to this law "a party in a contractual relation is required, while performing its obligation, to handle all its professional duties with care and with greater attention, according to the rules of the profession and

---

[27] Law on Commercial Companies, Articles 34–35.

[28] Law on Commercial Companies, Article 32.

[29] A. Tunc, "La distinction des obligations de résultat et des obligations de diligence", JCP 1945, I 449. Corporate Law of Pennsylvania defines this standard as a "care that is expected to be shown by a usually caring person, in a similar position, under similar circumstances". Similarly in: Revised Model Business Corporation Act, paragraph 8. 30 (a) (2). See: D. Branson, *Corporate Governance,* Washington, 1999, pp. 253–254 and 262–264; see also: Choper et al. (*supra* note 21), pp. 74–112.

customs (the due care of a good expert)".[30] The distinction of the "due care of a good expert" and "due care of a good businessman" is created in this law consciously and with the idea of prescribing the required level of care and responsibility. There is no doubt that the members of the governing board (directors) and executive directors (managers) are in a specific contract relationship with the company for which they are performing the representative function. Therefore, they are bound by the aforementioned standards of care when entering into the contracts in the name of the company.

The question was raised (for theory and judicial practice separately): whether, the standard of "due care of a good businessman" or the standard of "due care of a good expert" should be applied when referring to the responsibility of these individuals? The answer to this question lies in the character of the function of these persons – do these persons perform a professional activity that has its specific "rules of the trade and customs"? In a situation where the proper market in Serbia is just being formed and the profession of directors is just beginning to emerge in a new property environment, giving rise to "rules of the profession", it would seem difficult to plead that the abstract degree of care of directors can oscillate towards the "due care of a good expert". For now, bearing in mind the basic characteristics of our market surroundings, it would seem that the proper standard of care of directors is the "care of a good businessman."[31]

Finally, the Law on Commercial Companies of Serbia also accepts (a legal transplant from Anglo-Saxon law) the Business Judgment Rule, as a unique rule combining the three previously discussed duties of directors[32]: 1) The Fiduciary Duty (reasonably believes that the business decision is in the best interest of the corporation), 2) The Duty of Loyalty (not an interested party in the subject of a business decision – no existence of conflict of interest – duty of loyalty to the company when there is a conflict of interest), and 3) The Duty of Care (informed in regards to the subject-matter of a business decision in a way that he/she reasonably believes that it is appropriate in the circumstances of the case). If the aforementioned three suppositions are cumulatively fulfilled, then there is no liability of the directors for any loss flowing from the business decision.[33]

---

[30] Law on Contracts and Torts, Article 18, paragraphs 1 and 2.

[31] More: M. Vasiljevic, *Korporativno upravljanje – pravni aspekti (eng. Corporate governance – legal aspects)*, Belgrade, 2007, pp. 155–162.

[32] Ibidem, pp. 163–172.

[33] Law on Commercial Companies, Articles 32–35.

In the USA, this rule is a creation of *common law*[34] and is rarely codified in state laws.[35] The American courts characterize this principle with a formula that "regularly, neither the directors nor other managers of the corporation are liable for ordinary mistakes or errors in their judgment (executive decisions), regardless of their being legal or factual (but they are not exculpated from responsibility in the event of fraud, illegality and behavior outside the scope of their authority – *ultra vires*)."[36]

The Supreme Court of Delaware also formulated this rule (which is used frequently by state courts in the US, repeating all the elements from definition by the American Legal Institute) in the case of *Aronson v. Lewis*: "The assumption is that in making an executive decision, the corporate directors acted in a sufficiently informed fashion, conscientiously, with true (reasonable) conviction that they are acting in the best interest of the company".[37] One of the most cited cases of the Supreme Court of Delaware is *Warshaw v. Calhoun*: "In the absence of a showing of bad faith on the part of the directors or of a gross abuse of discretion, the business judgment of the directors will not be interfered with by the courts.... The acts of directors are presumptively acts taken in good faith and inspired for the best interests of the corporation and a minority shareholder who challenges their bona fides of purpose has the burden of proof."[38]

3. The Rights of Minority Shareholders

The Law on Commercial Companies of Serbia dedicates special attention to the protection of the rights of minority (and dissenting) shareholders,[39] introducing solutions which acknowledge a need to balance of interests of the majority (avoiding abuse by the majority) against those of the minority (staving off abuse by the minority). Basically, this is a case of a so-called second agency problem of corporate governance, conflict of interests of the majority shareholders and interests of minority shareholders, whereas in terms of resolving this problem, majority shareholders have a unique

---

[34] For the origin of the institution see: D. Block, N. Barton, S. Radin, *The Business Judgment Rule – Fiduciary Duties of Corporate Directors*, Fifth Edition, Volume I, Aspen Law & Business, pp. 9–11.

[35] See: Branson (*supra* note 29), pp. 328. Some of the authors divide this rule in five elements: 1) business decision, 2) non existence of interests and independence, 3) duty of care, 4) conscience, and 5) non-existence of abuse of discretionary authority. See: Block et al. (*supra* note 34), pp. 37–88.

[36] Block et al. (*supra* note 34), pp. 88–95.

[37] According to: Branson (*supra* note 29), pp. 329. For this term, look up French law and practice in: A. Guengant, P. Troussière, S. deVendeuil, *Le role des juges dans la vie des sociétés*, Paris, 1993, pp. 153–154; Schmidt (*supra* note 22), pp. 7–25.

[38] According to: Branson (*supra* note 29), pp. 330.

[39] More: M. Vasiljevic, *Company Law,* Belgrade, 2007, pp. 363–383.

position of an agent, whilst minority shareholders have a position of a principal (a unique fiduciary obligation of the majority shareholders to minority shareholders). To resolve this problem, the Law on Commercial Companies of Serbia establishes several separate rights of minority shareholders with a certain capital census (that are added to regular individual rights of shareholders depending on the class of shares).

Separate rights of minority shareholders according to the Law on Commercial Companies of Serbia are: 1) the right to convene the assembly of shareholders – possibility of judicial protection (capital census 10% of shares with a right to vote on issues proposed for the agenda),[40] 2) the right to propose an inclusion of up to two new issues into the proposed daily agenda of the assembly – possibility of a judicial protection (capital census 10% shares with a right to vote),[41] 3) the right to initiate a derivative action on the company behalf (capital census 5% of the company basic capital),[42] 4) the right to choose the board of directors of the company through the institute of cumulative vote,[43] 5) the right to leave the company (amendment to the foundation act which effects the rights of shareholders of the class of those shares, status changes and changes in the legal form, acquiring and disposal of property of great value, other cases established by the company act) with the obligation of the company to buy off shares of dissenting shareholders at the market price,[44] 6) the right to submit a request for liquidation of the company (capital census 20% of the basic company capital),[45] 7) the right to a group vote of the shareholders with preferential shares (class vote),[46] 8) the right for a special revision (expert trustee) – capital census 20% of the basic company capital,[47] 9) the "right" of forced sale (squeeze-out) or forced purchase – when an interest capital of 95% has been reached by public takeover.[48]

4. The relationship between the Company Law and the Capital Market Law

The Company Law and the Capital Market Law (Law on Stock-Exchange) are regulated by special laws in Serbia. Thus the main source of law for the Company Law is the Law on Commercial Companies and the Law on the

---

[40] Law on Commercial Companies, Articles 277–278.
[41] Law on Commercial Companies, Article 284.
[42] Law on Commercial Companies, Article 13, paragraph 10.
[43] Law on Commercial Companies, Article 309, paragraphs 4–6.
[44] Law on Commercial Companies, Articles 444–446.
[45] Law on Commercial Companies, Article 346.
[46] Law on Commercial Companies, Article 341.
[47] Law on Commercial Companies, Articles 334–336.
[48] Law on Commercial Companies, Articles 447–449; The Law on the Takeover of Joint–Stock Companies, Articles 34–35.

Registration of Businesses, while the main source of law for the Capital Market Law is the Law on the Market of Securities and other Financial Instruments and the Law on the Takeover of Commercial Companies. The sources of Company Law deal with foundations of commercial companies (founding, organization, governing, acts, capital and cessation by liquidation), while the sources for the Capital Market Law deal with the dynamics of commercial companies and the status of institutions on the securities market (issuance of serial securities, trading with serial securities, reporting on open companies, privileged information, Securities Commission, the stock market and organized capital markets, broker-dealer companies, Central Register of Securities, custody banks). The sources of law of the serial securities also regulate the takeover of joint stock companies by way of public tender. In the securities market a special role is played by the Securities Commission, as the special regulatory supervisory autonomous body with the capacity of a legal entity, which based on the law, adopts a series of regulations for the capital market. The stock exchange has the same function (for now there is only the Belgrade Stock Exchange, although the law allows the foundation of other organized capital markets), which with its acts regulates membership on the market and the listing of companies. In Serbian law there is a large legal gap in the regulation of the procedure for opening and closing commercial companies, bearing in mind that in that section there was a "conflict of competence" between the Law on Commercial Companies and the Law on the Market of Securities and other Financial Instruments.

5. The Efficiency of National Agencies for Enforcement of Judgments

The matter of enforcement of judgments in Serbia still lies within the competence of the courts, given that Serbia did not adopt a separate law on establishing a national agency for enforcement of judgments, which would issue licenses to private judgment enforcers. In any case, the area of enforcement of judicial decisions, due to traditional inefficiency of the courts, is not adequately regulated in Serbia and thus does not serve the needs of commercial entities. On the other hand, there are numerous national agencies founded in Serbia by special laws, which serve as regulatory bodies and whose acts have the character of administrative acts, which are directly enforceable (possible administrative disputes do not delay their enforcement). That is the case with the acts of: the Securities Commission, the Central Register for Securities, the Business Registers Agency (Register of Commercial Entities, register of pledges of movable assets and rights), the Agency for Energy Efficiency, the Agency for Radio-Diffusion Institutions, the Agency for Telecommunications, the Agency for Licensing Bankruptcy Managers, the Privatization Agency, etc.

Finally, a non-possessory pledge on movable assets and rights which are acquired by registering into an appropriate register had been established by special law[49] and the possibility for an out of court satisfaction of the creditors on such a pledged item or right prescribed. Similarly, with a separate Mortgage Law, as a type of a pledge on real estate that is acquired by registering into the competent Central register of mortgages (Cadastre of Real Estate), the possibility for an out of court satisfaction of the creditors has been prescribed (sales of real estate property by way of an auction or direct bargain).[50]

IV. The Judiciary in the Post-Codification Phase

1. The National Legal Tradition and Mechanisms for Resolving Disputes

Serbia, a country with a turbulent history, as a land of the Balkan region and as a small country, has a relatively strong and long legal tradition. It is little known that Serbia was the fourth country in Europe (following France, Austria and Holland), that had, on the basis of the Austrian Civil Code, passed its own Civil Code (1844). Unfortunately, numerous wars, especially the Second World War and the communists' regime which followed, had created a disruption in the legal continuity and the character of law, thus the legal system based on the market economy and the proprietary rights began to be re-established at the end of the last century and the beginning of this one.

Modern (not medieval) Serbia, this year marks two centuries since it first founded the first Commercial Court and 162 years since the foundation of the Supreme Court. At the end of 2008, Serbia had passed new judiciary laws, which transformed the Supreme Court into the Court of Cassation, and founded separate administrative courts. The tradition of separating the courts of general jurisdiction from the commercial courts continues. Serbia also has the Foreign-Trade Arbitration Court attached to the Chamber of Commerce of Serbia (founded in 1947), which settles commercial disputes with international elements when its jurisdiction is agreed upon. Within the scope of the Chamber of Commerce of Serbia, there is also the Court of Arbitration, which settles disputes of domestic commercial entities when its jurisdiction is agreed upon. With the Chamber of Commerce of Serbia and regional chambers of commerce, there are courts of honor that settle disputes pertaining to the violation of business prac-

[49] Law on Pledge on Movable Assets Entered into the Registry, The Official Gazette of the Republic of Serbia No. 57/03.

[50] Mortgage Law, The Official Gazette of the Republic of Serbia, No. 115/05.

tices and ethics. Finally, in the last couple of years, centers for mediation are being founded (independent or within the scope of Chambers and Courts), for the purpose of mediating in order to achieve amicable resolution of the disputes (commercial and civil).[51]

2. Judges positivists or a new approach to the regulated statuses (codifications after 1990)? How is the freedom of contract regulated?

Serbia as a country of continental legal tradition follows the legal reforms of European continental law, which are without a doubt under the influence of the Anglo-Saxon legal tradition. This is especially true for the institutes of the company and stock – exchange law (law on securities). Convergence of legal systems of continental law is evident and is developed both through a formal convergence (legal transplants and harmonization of the EU law), and through the factual convergence conditioned by a series of occurrences in the sphere of business life and business law (*supra* national status legal forms of companies, cross-border mergers, listing of companies on foreign stock markets, development of soft law, takeover, development and acceptance of a good corporate governance practices, influence of institutional investors, optional model of corporate governance, etc). Serbia fits into these processes as its capacities allow it, which are, unfortunately, in all fields still limited. Although it has a long tradition of having special commercial courts, the change in the character of the law and the character of the business regulations, in which broad legal standards of Anglo Saxon law are increasingly dominant ("interest of commercial companies", "reasonable belief", "justifiable belief in the expertise and competency", etc) or the concept of legal regulative is abandoned in favour of autonomous regulative ("soft law") or the legal gaps are required to be filled by using broad legal standards and principles, nevertheless cause serious problems for both judges and attorneys in Serbia. Judges at the Commercial Courts, additionally, as a rule, do not have practical experience acquired by working in companies and therefore, their positivism in legal reasoning is emphasized and markedly present, even decisive in their decision-making. It is also true, that a relatively short period of time has elapsed since the enactment of the new regulations which are based on the new philosophy of regulation, thus any relative theoretical generalization is rather difficult. However, first reviews reveal that there is no new approach, new decisions from which it is possible to observe a change in legal reasoning.

On the other hand, when we are referring to the freedom of contract, it has to be said that the contract law of Serbia has, in that sense, a long tra-

[51] Law on Mediation, The Official Gazette of the Republic of Serbia, No. 18/05.

dition. The Law on Contracts and Torts (1978) sets a strong principle of the "party autonomy": "The parties in contractual relations are free, within the limits of compulsory regulations, public order and good practices, to regulate their relations in accordance with their will".[52] This principle has been transferred from contract law to company law, and in essence it has been set as applicable to all closed forms of commercial companies under the name "principle of freedom of contracting": "partners in general partnership (valid for limited partnership and limited liability companies – author's remark) can organize their relations, and the relations with the general partnership freely, unless otherwise prescribed by the law".[53]

3. How do Judges apply Legal Transplants?

Following the privatization and return to the right of private propriety, Serbia is practically building a new legal system in the domain of economy (new company law, new bankruptcy law, new stock-exchange market law, new law on the protection of consumers, new law on the protection of competition, new law on intellectual property, new law on telecommunication, new law on energy, new law on takeover, new economic law, new economic penalty law, new tax law, new labour and social law, etc). It is clear that Serbia does not have the legal capacity to build a new original business law, nor does it have an objective need for it, nor do the circumstances in its surroundings allow for it. Hence, the orientation toward legal adoption and transplantation are quite understandable. Aspirations towards the EU membership and the signing and ratification of the Agreement on Stabilization and Association with the EU oblige Serbia to perform harmonization of its laws (coordinating local law with the EU law which is as such unified), whereas, aside for the system of options for a national regulative, there are no choices. Besides this, there are still significant differences in legal institutes in countries of continental Europe (Roman and Germanic tradition) and institutes of Anglo-Saxon law. In such cases the choice seldom serves to the taste and local legal culture, but various institutional lobbies (financial and governmental) that sometimes lead to a choice that is not justified from the aspect of legal certainty (e.g. discarding the system of land registry books and the introduction of the cadastre system and in that way the administrative instead of the judicial procedure; discarding of the judicial registration of commercial entities and the introduction of the system of registration with the administrative organ and by it the replacement of the judicial procedure with the administrative, etc.).

---

[52] Law on Contracts and Torts (1978), Article 10. On the principle of "the freedom of contract" and limitations to this principle, see: S. Perovic, *Obligaciono pravo* (*The Law on Obligations*), Belgrade, 1980, pp. 152–182.

[53] Law on Commercial Companies, Articles 54, 91, 105.

In any event, legal transplants, especially imposed ones, are difficult to be accepted by the local legal culture and tradition, and as such by the judges and the judiciary, thus their adequate implementation should not be expected. Similarly, "legal transplantation" of a series of judicial actions into the sphere of administration, which was introduced into Serbia by way of the "red carpet", does not lead to the raising of legal certainty and the need of further emancipation of the economy by the state. True, the time period in question is relatively short to be able to draw theoretical conclusions, but it would seem that on many issues, the choice could have been more "European" (either Roman or Germanic), which would make things easier for the judges and the judiciary, otherwise certainly required by the economy.

4. The relations between judges, practice and theory

In the continental legal tradition, as opposed to the Anglo Saxon legal tradition, judicial practice, formally, does not represent a source of law. Still, even though the decisions of the higher courts do not formally bind lower courts, the lower courts in Serbia, as rule, adhere to the legal rulings adopted by the higher courts. Particularly important for the unification of judicial practice are the so called *principle standpoints* on the application of certain legal norms, which are taken on by the highest courts, and the so-called *standpoints.*

In the domain of company law, the judicial (as well as arbitral) practice in Serbia is not developed, given that the relevant legal sources are recently enacted, and the time is needed to mark the trends in their application. Judicial practice should play a significant role in eliminating contradictions in the developing regulations, such as company and stock-exchange market laws, and fill the gaps in these regulations, which is a special way of creating the law. The judicial (and arbitral) practice of developed countries, that had enough time to influence the shaping of legal institutes from these areas, can act as a useful (but not as an uncritical) road sign to our budding judicial practice in this field.

It is a well known fact that for legal certainty in one country to exist, it is not sufficient to have adequate regulations; what is most important is their proper application in the judicial, arbitral and business practice. Every statute is as good as its application. Good application of the law can eliminate to a great deal its contradictions, inconsistencies, or deficiencies that are understandable for newer areas of law and legal institutes, and also logically originate in part from the abstract nature of the regulations as opposed to concrete business needs. Such application of law requires not only judges with high expertise, efficiency and independence, but judges that feel the needs of the economy and business sector and also have corre-

sponding experience. It is unacceptable that these issues are handled by judicial bureaucrats who do not have a day of experience, while judging business disputes of significant value, without the feeling of importance of a professional attitude and significance of time in economy.

Unlike judicial practice, legal science is neither formally nor factually a source of law, but it is to a great extent an interpretative source, considering that it can in different ways influence the legislative and judicial practice (critical presentations and proposals of laws, critical presentations and suggestions to the judicial and arbitration practice, participating in formulating court's positions and principle opinions, participating in various forms of processes in adopting laws and interpreting them, etc). There is a special task of legal science in the development of the comparative legal method of studying regulations of developed laws, which is the best way to critically approach the existing legislative and judiciary practice. The legal science of all areas of business law, including company law, is not particularly developed in Serbia, as is the case with the legislature and practice. Serious development of the critical legal science (not commercial) based on relevant research of comparative legal material is a task faced by all responsible universities (that even with the intentions of the so-called Bologna process, have the justified intention to remain scientific, and not only educational institutions) and institutes in Serbia. That is the road to creating a company law *de lege ferenda* with long term value, as well as an exemplary judicial, arbitral and wholesome business practice.

V. In lieu of a Conclusion

On the road to development of both the national soft law and the European law, legal theory must seek adequate answers to at least the following eleven open questions:

1. more or less European law (the need for a single legal framework created "from the top") or more or less national laws (the need for competition amongst national laws as the possible road to harmonization "from the bottom" based on the selection of the most competitive law);
2. more or less creation of European law with "interventions" of the European legislature, judicial and executive power (harmonization "from the top") or more or less by way of broadening and unified acceptance of legal transplants (harmonization "from the bottom");
3. more or less civil law (Roman or Germanic) or common law in the law of the EU;
4. more or less mandatory law or more or less default law within the EU law;

5. more or less "soft law" or more or less "hard law" in the EU;
6. more or less European law which institutionalizes the social market economy system or more or less European law which institutionalizes a system of "total" market economy;
7. more or less European law which promotes a system of social responsibility of companies (owners, creditors, employees, management, the state, local community, consumers) or more or less European law which promotes a system of companies responsible only to owners;
8. more or less codified European law or more or less non-codified European law;
9. Codified European law in one act or codified European law in multiple acts;
10. A single European law or European law for developed countries and European law for countries in transition, and
11. European law (separate business law) prior to the economic crisis and European law following the economic crisis (can the philosophy of the regulations be the same)?

Russian Company and Capital Market Law

ALEXANDRA MAKOVSKAYA*

I. Brief Survey of the Company Law System

The economic revolution in the Union of Soviet Socialist Republics (hereinafter – the USSR) and the Russian Soviet Federated Socialist Republic (hereinafter – the RSFSR), which took place simultaneously, instantly transformed most previous legislation into a historical monument. Thus, the Russian legislation governing the formation and operation of commercial entities is relatively new. The process of evolution of modern company law may be divided into several successive periods.

The first period (1988–1991) started with the transition of the planned economy to a market economy.[1] It was a short period in the history of the USSR – the beginning of economic reform (the period of known as "perestroika"), and the period of adaptation of the soviet law to the needs of a market economy. This period can be characterized as an opposition be-

* The views expressed in this article are the personal views of the author and do not represent the views of the Supreme Commercial Court of the Russian Federation. For a survey of the latest company law trends in Russia, see Zaitsev *infra* pp. 315 et seq.

[1] G.V. Tsepov, *Aktsionernye obshchestva: teorija i praktika* [Public companies: theory and practical experience], Moscow 2009, p. 10.

tween the authorities of the Russian Federation (hereinafter – the RF) and of the USSR and contradiction between former and new legal acts. The new company law of the USSR and the new company acts of Russia were modified simultaneously. The USSR Law on Ownership[2] and the USSR Law on Enterprises[3] were enacted in 1990. In the same year on the level of the Russian Federation, the Law on Ownership[4] and the Law on Enterprises and Entrepreneurial Activity[5] were enacted. On 19 June 1990 the Council of Ministers of the USSR adopted the Statute on Joint Stock Companies and Limited Liability Companies and the Statute on Securities[6]. On 25 December 1990 the Council of Ministers of the RSFSR approved the Statute on Joint Stock Companies[7].

At the end of 1991, the USSR ceased to exist and this event led to a new stage in the development of Russian company law. The second period (1992–2001) may be characterized by a wide process of privatization, drafting and enacting new Russian legislation concerning legal entities.[8] This period was dedicated to creating the market economy, establishing the major Russian companies and enacting the main Russian laws, including the Constitution of the RF.

The first part of the Civil Code of the Russian Federation[9] containing the general provisions on legal entities went into effect on 1 January 1995. The Civil Code defines the basic rules for the creation and activity of legal entities. The Law on Joint Stock Companies (dated 26 December 1995)[10]

---

[2] Zakon SSSR ot 06.03.1990 "O sobstvennosti v SSSR" published in the Bulletin of the Supreme Soviet of the RSFSR 1990, No. 11, Pos. 164.

[3] Zakon SSSR ot 04.06.1990 N 1529-1 "O predpriiatiiakh v SSSR" published in the Bulletin of the Supreme Soviet of the RSFSR 1990, No. 25, Pos. 460.

[4] Zakon RSFSR ot 24.12.1990 N 443-1 "O sobstvennosti v RSFSR" published in the Bulletin of the Supreme Soviet of the RSFSR 1990, No. 30, Pos. 416.

[5] Zakon RSFSR ot 25.12.1990 N 445-1 "O predpriiatiiakh i predprinimatel'skoi deiatel'nosti" published in the Bulletin of the Supreme Soviet of the RSFSR 1990, No. 30, Pos. 418.

[6] Postanovlenie SM SSSR ot 19.06.1990 N 590 "Ob utverzhdenii Polozheniia ob aktsionernykh obshchestvakh i obshchestvakh s ogranichennoi otvetstvennost'iu i Polozheniia otsennykh bumagakh" published in SP SSSR 1990, No. 15, Pos. 82.

[7] Postanovlenie Sovmina RSFSR ot 25.12.1990 N 601 (red. ot 15.04.1992, s izm. ot 24.11.1993) "Ob utverzhdenii Polozheniia ob aktsionernykh obshchestvakh" published in SP RSFSR 1991, No. 6, Pos. 92.

[8] Tsepov (*supra* note 1), p. 17.

[9] Chast' pervaia Grazhdanskogo kodeksa RF published in Sobranie Zakonodatel'stva RF, 05.12.1994, No. 32, Pos. 3301.

[10] Federal'nyi zakon ot 26.12.1995 No. 208 "Ob aktsionernykh obshchestvakh" published in Sobranie Zakonodatel'stva RF, 01.01.1996, No. 1, Pos. 1.

and the Law on Limited Liability Companies (dated 8 February 1998)[11] defines in detail the legal status of these two important types of private legal entity.

The legislation on privatization of state and municipal enterprises consisting of numerous legal acts established the legal basis for the establishment of joint stock companies in the procedure of privatization. It determined the specifics of the formation and legal status of joint-stock companies created by the privatization of state and municipal enterprises. The Law on Privatization of State and Municipal Enterprises was enacted on 3 July 1991[12] and was replaced by the Law on Privatization on State and Municipal Property in the Russian Federation on 21 December 2001[13].

The next period (2002–2008) can be described as a time of gaining experience in the application of the new Russian legislation by courts and companies.[14] The current period is a period of modernization for Russian legislation. According to the Decree of the President of the Russian Federation on improvement of the Civil Code of the Russian Federation[15] adopted on 18 July 2008 the guidelines concerning the development of civil legislation should be completed by 1 June 2009. One of the parts of these guidelines will deal with company law.

II. The Idea and Process of Codification

Company law is a part of Russian civil legislation. The Civil Code of the RF, sometimes called the "Constitution of the Economy", defines the basic contents of Russian company law[16]. Firstly, the Civil Code of the RF determines the basic rules for all legal entities in the Russian Federation[17].

---

[11] Federal'nyi zakon ot 08.02.1998 No. 14 (red. ot 27.12.2009) "Ob obshchestvakh s ogranichennoi otvetstvennost'iu" published in Sobranie Zakonodatel'stva RF, 16.02. 1998, No. 7, Pos. 785.

[12] Zakon RF ot 03.07.1991 No. 1531-1 "O privatizatsii gosudarstvennykh i munitsipal'nykh predpriiatii v Rossiiskoi Federatsii" published in Bulletin of the Supreme Soviet of the RSFSR, 04.07.1991, No. 27, Pos. 927.

[13] Federal'nyi zakon ot 21.12.2001 No. 178 "O privatizatsii gosudarstvennogo i munitsipal'nogo imushchestva" published in Sobranie Zakonodatel'stva RF, 28.01.2002, No. 4, Pos. 251.

[14] Tsepov (*supra* note 1), p. 18.

[15] Ukaz Presidenta RF ot 18.07.2008 No. 1108 "O sovershenstvovanii Grazhdanskogo kodeksa Rossiiskoi Federatsii" published in Sobranie Zakonodatel'stva RF, 21.07.2008, No. 29 (Part 1), Pos. 3482.

[16] I.S. Shitkina, in I.S. Shitkina, ed., *Korporativnoe pravo* [Company law], Moscow 2007, p. 42.

[17] N.D. Egorov, in A.P. Sergeev, I.K. Tolstoi, eds., *Grazhdanskoe pravo* [Civil law], Moscow 2003, p. 38.

Some of the Civil Code's provisions governing the activity of commercial and non-commercial organizations were directly applicable rules from the moment the Civil Code came into force. Included among these are the general rules applicable to all types of legal entities and especially to commercial organizations. Secondly, the Civil Code of the RF is the basic law for several types of commercial organization and the rules it contains act as specific laws. For example, according to Article 96 of the Civil Code of the RF the legal status of a joint stock company and the rights and duties of shareholders shall be determined in accordance with the Code and the law on joint stock companies. Currently three special laws containing such provisions are in effect. They are:

- Federal Law on Joint Stock Companies, dated 26 December 1995
- Federal Law on Limited Liability Companies, dated 8 February 1998
- Federal Law on State and Municipal Unitary Enterprises, dated 14 November 2002[18].

The legal status of some companies such as banks, insurance companies, investment funds and companies established by the process of privatization are determined by laws specific to these types of companies.

The Civil Code of the RF heads the hierarchy of legal acts on company law[19]. The special laws for different types of companies and a few other laws such as the Law on Securities Market form the next level of this hierarchy. The Joint Stock Companies Law determines the procedure for the formation, re-organization, liquidation and the legal status of joint-stock companies, the rights and duties of their shareholders, and ensures the protection of the rights and interests of shareholders.[20] The Securities Market Law[21] deals with matters concerning the procedure for the issue of shares and other securities and regulates the activity of professional participants in the securities market. It should be noted that there are several overlaps in the application of these laws. The most important is the regulation of the procedure for the issue of shares and maintaining and storing the register of shareholders of a company.[22] If not prohibited by the Civil Code of the RF and other laws, the aforementioned provisions may evolve into other legal acts, including the acts of the Federal Financial Markets

---

[18] Federal'nyi zakon ot 14.11.2002 No. 161-FZ (red. ot 01.12.2007) "O gosudarstvennykh i munitsipal'nykh unitarnykh predpriiatiiakh" (priniat GD FS RF 11.10.2002) published in Sobranie Zakonodatel'stva RF, 02.12.2002, No. 48, Pos. 4746.

[19] M.I. Braginskii and V.V. Vitrianskii, *Dogovornoe pravo* [Contract law] Moscow 1997, p.37.

[20] O.A. Makarova, *Korporativnoe pravo* [Company law] Moscow 2005, p. 28.

[21] Federal'nyi zakon "O rynke tsennykh bumag" ot 22.04.1996 No. 39-FZ published in Sobranie Zakonodatel'stva RF No. 17, 22.04.1996, Pos. 1918.

[22] Makarova (*supra* note 20), p. 29.

Service (FFMS). The Federal Financial Markets Service has the power to regulate, in accordance with law, the activity of companies in financial markets and to establish some rules concerning corporate governance.[23] For example, Article 47 of the Law on Joint Stock Companies stipulates that the federal executive body in charge of the securities market may establish additional rules governing the procedure for preparing, convening and holding a general meeting of shareholders. Making the most of this provision the Federal Securities Market Commission (currently known as the Federal Financial Markets Service) approved the Regulations on Additional Provisions Governing the Procedure for Preparation, Convocation and Holding of a General Meeting of Shareholders on 31 May 2002[24].

Company law in the Russian Federation contains two types of rules: mandatory and non-mandatory. Mandatory rules are obligatory for all companies, for their members and shareholders. It is obvious that it is necessary for legal entities to have a clear status to ensure the stability of commercial relationships. The provisions of a company's internal documents (including the charter of a company) that conflict with these mandatory rules are invalid. Non-mandatory rules permit companies to include provisions that may differ from the rules provided by law in their charters and other documents. Usually the balance between mandatory rules and non-mandatory rules shows the degree of evolution in a market's economy, civil community and the level of legal culture in a country. Depending on the specific type of a legal entity, this balance may be different. For example, the Law on Joint Stock Companies contains more mandatory rules than the Law on Limited Liability Companies.

Russian civil law traditionally belongs to the system of European continental law[25]. The current Civil Code of the RF drafted and enacted in the period 1994–2008 reflects the general development trend for civil law in a number of other European countries – including Germany, the Netherlands, Italy, and Switzerland, and experts from these countries took a very active part in the process of creating the Civil Code. It should be noted that Dutch lawyers made the most important contribution to this work. However, the Civil Code of the RF is not a mere copy of the civil and commercial codes of these countries. This Code is the result of the intensive efforts by Russian lawyers with the assistance of their foreign colleagues. But the

---

[23] Tsepov (*supra* note 1), p. 27.

[24] Postanovlenie FKTSB RF ot 31.05.2002 No. 17/ps (red. ot 07.02.2003) "Ob utverzhdenii Polozheniia o dopolnitel'nykh trebovaniiakh k poriadku podgotovki, sozyva i provedeniia obshchego sobraniia aktsionerov" (Zaregistrirovano v Miniuste RF 16.07. 2002 No. 3578), published in Biulleten' normativnykh aktov federal'nykh organov ispolnitel'noi vlasti, No. 31, 05.08.2002.

[25] Ivanov, in A.P. Sergeev, I.K. Tolstoi, eds., *Grazhdanskoe pravo* [Civil law], Moscow 2003, p. 78.

influence of foreign legislation has one drawback. The problem is that these countries with civil law traditions based on the Continental European legal family have grown to include two areas of law based on American law, i.e. securities market law and company law. This influence of American company law may be explained by the importance of the American securities market in the world, on the one hand, and the assistance of American experts in the work on these bills, on the other.

The first legal acts dealing with joint stock companies elaborated on the basis of American law and were enacted before the first part of the Civil Code of the RF had come into force. Those drafting the Civil Code of the RF were to follow the main provisions of these acts, as radical changes to the company legislation was not possible at the time. Later the new draft of the Law on Joint Stock Companies was prepared on the basis of the Civil Code of the RF and more detailed rules concerning this type of legal entity were transplanted into Russian legislation from American law. This resulted in the appearance of foreign rules in Russian law. Neither courts, nor companies had had experience with the application and interpretation of these rules. For example, the notions of 'interested-party deals' and 'major deals' were introduced into federal law in this way. Borrowings such as this led to mistakes that now cannot be easily corrected. Thus, under the law, it is possible to establish legal entities such as a closed joint stock company or an open joint stock company and limited liability company. The status of the supervisory council provides another example of inconsistency. In Russian legislation it is equivalent to the board of directors, though in American law it is considered to be a special independent body[26]. Today the relationship between Russian company law and American law is not so close.

At first glance the relationship between European Law and Russian company law does not seem to be evident, but the similarities and overlaps between Russian law and European Union Law are numerous. Of course the influence of the EU law on Russian legislation is explained more by the modern tendency of globalization of securities and finance markets, rather than the perspective membership of the Russian Federation in the European Union. Some major Russian companies whose shares are publicly traded in Russia wish to enter foreign capital market and attract foreign investors. They understand that to achieve this goal, they need to comply with the high standards of corporate governance and information disclosure required by EU law. The Russian legislator has taken these intentions into account and recent Amendments to the Law on Joint Stock Companies have been based on the provisions of the EU Directive on

[26] Tsepov (*supra* note 1), p. 159.

Takeover Bids[27]. The new bill concerning insider information and market manipulation corresponds with the EU Directive on Insider Dealing and Market Manipulation[28].

III. Specific Company Law Issues

1. Relevance of Codes on Corporate Governance

The Code on Corporate Governance was approved by the Government of the Russian Federation on 28 November 2001, and on 4 April 2002 this Code was adopted by the Federal Commission for the Securities Market (FCSM)[29]. The Federal Commission only recommended that Russian joint stock companies should follow its provisions, meaning that the Code's provisions have no obligatory force per se. Any company may choose whether to observe all the provisions of the Code, to comply with some of them or to disregard them completely. However, the Federal Commission introduced two requirements that do limit that freedom of choice somewhat, effectively forcing companies to observe the Code. These measures include a recommendation that companies should disclose information about the implementation of the Code's provisions in annual reports and a recommendation to all Russian stock exchanges and trading systems that these requirements should be included in their listing rules. The Code is primarily aimed at listed open joint stock companies. The decision of a company to follow the Code's provisions may be implemented in different ways. Sometimes companies include these provisions in their own charters. Some of the open joint stock companies such as "Sibneft" (OAO "Сибнефть"), "Lukoil" (OAO "ЛУКОЙЛ"), Mining and Metallurgical Company "Norilsk Nickel" (OAO "Норильский никель") and others, have adopted their own codes on corporate governance[30]. Alternatively, a company may include these provisions in the internal documents that

---

[27] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance) Official Journal L 142 , 30/04/2004 P. 0012–0023 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0025:EN:HTML>.

[28] Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation (Text with EEA relevance) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0124:EN:HTML>.

[29] Rasporiazhenie FKTSB RF ot 04.04.2002 No. 421/r "O rekomendatsii k primeneniiu Kodeksa korporativnogo povedeniia" (vmeste s "Code on Corporate Governance" ot 05.04.2002) published in Vestnik FKTSB Rossii, No. 4, 30.04.2002.

[30] Cf. Makarova (*supra* note 20), p. 44.

govern the operation of the company's organizational bodies. There are other various possibilities for implementing the Code's provisions in corporate practice. In all cases the provisions of these acts bind not only the company itself, but also the company's shareholders and management boards.

Undoubtedly, one of the most effective ways to make companies apply the provisions of the Code is to include them in legislation.[31] But the law making process takes a significant amount of time and only few of these provisions have been included in the Law on Joint Stock Companies. For example, the provision in the Code for cumulative voting to elect members to the board of directors as a means of protecting the rights of minority shareholders has now been introduced into the Law on Joint Stock Companies.[32]

On the basis of the Code's provisions the Federal Commission has adopted and plans to adopt further regulations concerning such issues as the disclosure of information by companies, and the convocation of and preparation for the general shareholders meetings.[33] In some cases, the provisions of the Code may be viewed as general business customs.[34] According to Article 5 of the Civil Code of the RF, a business custom is an established rule of behaviour not provided for by legislation, but which is widely applied in certain areas of entrepreneurial activity, regardless of whether it is fixed in any document. A general business custom in corporate relationships is a source of company law and is applied as such by the court.[35]. For example, the Law on Joint Stock Companies does not set out any requirement concerning a place of general meeting of shareholders of a company. The Regulations on Additional Provisions Governing the Procedure for Preparation, Convocation and Holding of a General Meeting of Shareholders approved by Decision of the Federal Securities Market Commission N 17/ps, dated 31 May 2002[36], stipulate that general meetings of shareholders shall be held in the place of company's operation or in a location expressly identified by the company's charter.

The Code on Corporate Governance provides that places and times making it difficult for shareholders to participate in the meeting or would

---

[31] Makarova (*supra* note 20), p. 45.

[32] Shitkina (*supra* note 16), p. 338.

[33] For example: Prilozhenie 1 "Polozheniia o deiatel'nosti po organizatsii torgovli na rynke tsennykh bumag", utverzhdeno Prikazom FSFR RF ot 09.10.2007 No. 07-102/pz-n (Zaregistrirovano v Miniuste RF 14.11.2007 No. 10489), published in Biulleten' normativnykh aktov federal'nykh organov ispolnitel'noi vlasti, No. 8, 25.02.2008.

[34] Tsepov (*supra* note 1), p. 32.

[35] T.V. Kashanina, *Korporativnoe (vnutrifirmennoe) pravo* [(Internal) Company law], Moscow 2003, p. 90.

[36] See N. 18.

cause them to incur unnecessary expenses, should not be chosen for general shareholders' meetings.[37] Applying a similar idea, the Presidium of the Supreme Commercial Court of the RF qualified a provision in the charter of one Russian company as an abuse of this right, as it stipulated a location for the shareholders meeting which was beyond the boundaries of the territory of the Russian Federation (decision N 127, dated 25 November 2008)[38].

2. Relationship Directors – Shareholders

Generally, the structure of management bodies in a company includes two levels – the board of directors (the supervisory board) and the executive bodies (sole executive officer or chief executive officer who is named director general; and/or collective executive body).

The board of directors determines the general strategy of the company. As Article 64 of the Law on Joint Stock Companies states, in a company with less than fifty shareholders possessing voting shares, the charter of the company may provide that the functions of the board of directors shall be carried out by the general meeting of shareholders.

The members of the board of directors of a company are elected by the general meeting of shareholders. In a company with golden shares, the state has the right to appoint a member of the board of directors. As a rule, the board of directors consists of three categories of directors – executive (the members of the board of directors who are simultaneously members of the collective executive body), non-executive and independent directors.[39] Article 82 of the Law on Joint Stock Companies defines an "independent director" as a member of the board of directors of a company who is not currently, nor was, in the year preceding a decision being made:

- a person performing/who performed the functions of sole executive officer of the company, member of the collective executive body, or a person occupying/who occupied any position in the management bodies of the management organization;
- a person whose spouse, parents, children, siblings and half brothers and sisters, step-parents and step-children occupy/occupied positions in the said executive bodies of the company, the management organization or are managers of the company;

---

[37] Article 1.6 Russian Code on Corporate Governance.

[38] Punkt 5 Informatsionnogo pis'ma Prezidiuma VAS RF ot 25.11.2008 No. 127 "Obzor praktiki primeneniia arbitrazhnymi sudami stat'i 10 Grazhdanskogo kodeksa Rossiiskoi Federatsii" published in Vestnik VAS RF, No. 2, February 2009.

[39] Tsepov (*supra* note 1), p. 163.

– an affiliated (related) person of the company, except for a member of the board of directors (the supervisory board) of the company.

The definition of an "independent director" is also given in the Code on Corporate Governance. It is stricter and has larger scope of implementation than the one provided by the Law on Joint Stock Companies[40]. Apart from the member of the board of directors appointed as a representative of the state, the other members do not officially represent the shareholders, who nominated them as candidates to the board of directors and/or voted for them. Instead, members of the board of directors and other executive officers are generally liable only to the company and not to the shareholders. The members of the board of directors and other executive officers only bear liability directly to the shareholders in some special cases provided by law.[41]

According to Article 53 of the Civil Code of the RF "a person who acts on behalf of the legal entity – by force of law or its founding documents – must act in good faith and reasonably in the interests of the legal person represented thereby. Upon demand of the founders (participants) of the legal entity, it is required to indemnify the damages caused by it to the legal person unless otherwise provided for by a law or the contract". Article 71 of the Law on Joint Stock Companies provides similar rules. This article obliges the members of the board of directors and executive officers (such as a sole executive officer and members of the collective executive body) to act in the interests of the company and to exercise their rights and perform their duties with respect to the company reasonably and in good faith.

The Law on Joint Stock Companies does not determine the principles of reasonableness and good faith, but it does state that the persons listed above shall bear responsibility to the company for losses caused to the company due to their actions (or failure to act), unless other grounds for responsibility have been established by federal laws. Taken together these provisions effectively mean that a person is not considered to be at fault, if he acted reasonably and in good faith. The Civil Code of the RF states that a person is considered not to be at fault if all measures for the proper performance of the obligation have been taken with the degree of care and caution required by the nature of the obligation and the conditions of commerce, (Article 401 of the Civil Code of the RF). This objective criterion for the absence of fault introduced by the Code can also be viewed as the criterion of reasonableness and good faith.

---

[40] Shitkina (*supra* note 16), p. 337.

[41] Cf. A.E. Molotnikov, in I.S. Shitkina, ed., *Korporativnoe pravo* [Company law], Moscow 2007, p. 484.

The Code on Corporate Governance contains a number of recommendations, concerning the activity of members of the board of directors and other executive officers and the fulfilment their duties.[42] While the Code is not officially binding per se, Article 71 of the Law on Joint Stock Companies provides that when determining the grounds and extent of responsibility of members of the board of directors, the ordinary course of business and other circumstances bearing on the matter must be taken into account. This provision means therefore that the recommendations of the Code on Corporate Governance will be applied by court when they become business customs.[43]

According to Article 71 of the Law on Joint Stock Companies, a company or shareholders possessing no less than 1 per cent of the common shares of the company has the right to file a suit in court against a member of the board of directors or other executive officer for compensation of losses caused to the company. In this case, the shareholder acts on behalf of the company.[44] According to the provision of the Civil Code of the RF, the liability of the members of the board of directors and other executive officers is unlimited, but usually they do not possess enough assets to compensate the damage caused to the company.

3. Rights and Remedies for shareholders (esp. Minority Shareholders)

Article 31 of the Law on Joint Stock Companies provides that a shareholder has the following rights depending on the number of shares he owns:

- the right to participate in general meetings of the shareholders with the right to vote on all matters within its authority;
- the right to receive dividends, and
- the right to receive part of the company's assets in case of liquidation of the company. In order to exercise these rights, the Law on Joint Stock Companies stipulates that any shareholder, regardless of the number of shares he possesses has the following additional rights:
- the right to receive information and documents, concerning the company (Article 91);
- priority right to acquire additional shares and securities convertible into shares placed by public subscription proportionally the number of shares of this category (type) he owns (Article 40);
- where the shareholder voted against, or did not take part in voting on the issue of these shares and securities, he has a priority right to acquire

[42] Article 3.1 Russian Code on Corporate Governance.
[43] Shitkina (*supra* note 16), p. 342.
[44] Molotnikov (*supra* note 41), p. 478.

additional shares and securities which can be converted into shares, placed by closed (private) subscription proportional to the number of shares of this category (type) he owns.

Some of the rights may be exercised by shareholders who have the required number of voting shares required by the Law on Joint Stock Companies. Shareholders possessing at least one per cent of vote have the right to receive a list of persons entitled to attend the general meeting of shareholders (Article 51) from the company and may, on behalf of a company, apply to a court against a member of the board of directors or other executive officer for the compensation of losses caused to the company (Article 71). A shareholder owning at least two per cent of the voting shares of a company has the right to put issues on the agenda of an annual general meeting of the company and to nominate candidates to the company's board of directors, collective executive body, in-house audit commission and the accounts commission (Article 53). A shareholder who owns at least ten per cent of the voting shares of a company may convene an extraordinary general meeting of shareholders (Article 55). Shareholders owing twenty five per cent of the voting shares may receive accounting documents and the minutes of meetings of the collective executive body (Article 91). They may block any decision of the meeting of shareholders that requires a qualified majority of votes (for example, a decision on the amendment of company's charter). The company's charter may impose limits on the quantity and total par value of shares held or the maximum number of votes cast by a shareholder (Article 11).

To protect the rights of the shareholders, the law provides certain remedies.

Article 12 of the Civil Code of the RF states that the protection of civil rights including the rights of shareholders may be effectuated by the following means:

- recognition of the right;
- restoration of the situation that existed before the violation of the right and stopping the activities that violated the right or created a threat of its violation;
- declaration of a voidable transaction as invalid and/or applying the consequences of its invalidity;
- self-protection of a right;
- a judgment for performance of an obligation in kind;
- compensation for damages;
- recovery of a penalty;
- compensation for moral harm;
- termination or alteration of legal relationship;

- Court decision rendering an act of state or municipal agency that contradicts a statute non-applicable.

Article 13 of the Civil Code of the RF gives court the power to declare a legal (normative or non-normative) act of state or municipal body invalid.

The provisions of these articles provide the basic list of actionable claims which shareholders may take to court. Some of the claims a shareholder may file are directly named in the Law on Joint Stock Companies and other statutes.

According to Article 47 of the Law on Joint Stock Companies, a shareholder has the right to appeal a decision approved by the general meeting of shareholders in court, where such a decision violates the requirements of that Law, other laws of the Russian Federation, or the charter of the company, if the shareholder did not take part in the general meeting of shareholders or he voted against the approval of the decision and his rights and legal interests were violated by the decision.

A shareholder also has the right to appeal a decision of the board of directors or executive body of a company in court if the approval of this decision violates the requirements of the Law, the charter of the company and the rights and legal interests of the shareholder.[45] In some instances provided by law, a shareholder can demand the purchase or acquisition by the company of all or part of the shares owned by him (Articles 72–76). Some company transactions may be declared invalid or void by court on a shareholder's complaint (for example, major deals and interested-party deals – deals with conflict of interests).[46] A shareholder has the right to receive damages to compensate for a loss of shares. The company and the registrar appointed by it are jointly and severally responsible to the shareholder.[47] A shareholder has the right to file a suit in court against a member of the board of directors for compensation of losses caused to the company. Additionally, a shareholder has the right to appeal the legal acts of the Federal Financial Markets Service or other state bodies in court, if he considers these acts to violate his rights.

From the moment of coming into force, any judgment or other judicial act of the commercial court, or the court of general jurisdiction, is binding for all state and municipal bodies, organizations, officials, individuals and shall be executed by the parties voluntarily or by a bailiff in accordance with the procedure established by law (Bailiffs Service).

---

[45] For details see: Postanovlenie Plenuma Vysshego Arbitrazhnogo Suda RF ot 18 November 2003 No. 19 "O nekotorykh voprosakh primeneniia Federal'nogo zakona 'Ob aktsionernykh obshchestvakh'".

[46] D.I. Dedov, in I.S. Shitkina, ed., *Korporativnoe pravo* [Company law], Moscow 2007, p. 562.

[47] Dedov (previous note), p. 540.

The general rules for the enforcement of a court's decisions are provided by the Law on Enforcement Procedure enacted on 14 September 2007[48]. The efficiency of this procedure depends on the cause of action in a case and the subject matter of the court's judgment. There is a clear enforcement procedure for court decisions concerning a monetary claim. Where the amount of money available is insufficient to fulfil the claim, the bailiff may seize other property of the debtor. However the enforcement of other types of court decisions may pose a problem. Most court decisions on corporate disputes don't involve monetary claims.

IV. Administration of Justice in the Post-Codification Phase

1. National legal traditions and dispute settlement mechanisms

There are two court systems in the Russian Federation which deal with civil and commercial disputes:

- the courts of general jurisdiction with the Supreme court of the RF at the head; and
- the commercial (arbitration, or economic) courts. The Supreme Commercial Court of the Russian Federation heads this branch of the courts.

The existence of two branches of courts in Russia is due to historic traditions. In 1832 the commercial courts were set up in Russia to deal with commercial disputes between legal entities and businessmen.[49] After the October Revolution 1917 this commercial court system was transformed into the system of State Arbitrazh (госарбитраж), which had been especially adapted to handle disputes between state enterprises.[50] The disputes between citizens, arising from various civil law relations were settled by the courts of general jurisdiction. But until the beginning of 1990s, citizens and private organizations did not play a major role in the economic life of the country.[51]

Economic reforms and the development of market relations showed the need to set up specialized economic courts. The system of State Arbitrazh was dissolved and the system of commercial courts was created in its place in accordance with the Law of the RSFSR on the Commercial Courts,

---

[48] Federal'nyi zakon ot 02.10.2007 No. 229-FZ "Ob ispolnitel'nom proizvodstve" published in Sobranie Zakonodatel'stva RF 08.10.2007, No. 41, Pos. 4849.

[49] V.V. Iarkov, in V.V. Iarkov, ed., *Arbitrazhnyi protsess* [Commercial process], Moscow 2008, p. 6.

[50] Iarkov (previous note), p. 7.

[51] Iarkov (*supra* note 49), p. 8.

enacted in 1991[52]. At that time, the commercial courts handled "economic disputes arising from civil, administrative and other legal relations, between legal entities, and physical persons who perform entrepreneurial activities without forming a legal entity and are licensed as an individual entrepreneur". This reform did not affect the courts of general jurisdiction, which continued to resolve cases arising from civil relations regardless of whether one or both parties to a dispute was a person (citizen), but not an individual entrepreneur. Since that time defining the competence of the courts of general jurisdiction and the commercial courts has continued to be one of the most complicated and important problems facing the reform process, especially in the sphere of corporate disputes.

Now according to the general provisions of the Code of Commercial Court Procedure enacted in 2002[53] the commercial courts may settle all economic disputes and other commercial disputes arising from entrepreneurial and other economic activities in which legal entities and individual entrepreneurs take part.

Article 33 of the Code of Commercial Court Procedure[54] sets forth that several categories of dispute fall within the jurisdiction of the commercial courts regardless of whether the parties to these disputes are legal entities, individuals or individual entrepreneurs. The list of these disputes is as follows:

- insolvency (bankruptcy),
- isputes involving establishment, reorganization and liquidation of organizations,
- refusal or failure to register legal entities and individual entrepreneurs;
- disputes between shareholders and joint stock companies, between members of other commercial companies and partnerships arising from the activities of the companies and partnerships, except for labour disputes;
- protection of business reputation;
- other cases provided by law.

The basic idea of Article 33 of the Code is to exclude all disputes named thereunder from the competence of the courts of general jurisdiction. The

---

[52] Zakon RSFSR ot 04.07.1991 No. 1543-1 (red. ot 24.06.1992) "Ob arbitrazhnom sude" published in Vedomosti SND i VS RSFSR, 01.08.1991, No. 30, Pos. 1013.

[53] Arbitrazhnyi protsessual'nyi kodeks Rossiiskoi Federatsii ot 24.07.2002 No. 95-FZ published in Sobranie Zakonodatel'stva RF, 29.07.2002, No. 30, Pos. 3012.

[54] Art. 33 was amended by the Federal Law of 19 July 2009 No. 205 "O vnecenii izmenenii v otdel'nye zakonodatel'nye akty Rossiiskoi Federatsii". Furthermore, the new Chapter 28.1 "On corporate disputes" was inserted in the Code of Commercial Procedure so that the disputes listed below concerning the construction of Art. 33 have become obsolete (editor's note).

Civil Procedure Code adopted in 2002[55], takes the provisions of Article 33 of the Code of Commercial Court Procedure into account, stating that the courts of general jurisdiction are responsible for disputes involving individuals, organizations, federal and local bodies that arise from civil, family, labour, housing, land, environment and other civil relations, except cases where the law leaves these disputes to the jurisdiction of the commercial courts (Article 22).

So far, commercial courts have handled the biggest part of the company disputes, but this solution of the demarcation issue regarding the competence of the two systems is neither really satisfactory nor sufficient.

Firstly, the provisions of Article 33 of the Code of Commercial Court Procedure do not cover all corporate cases (company disputes). For example, this article names disputes between shareholders and joint stock companies, but does not mention disputes between the shareholders themselves, between shareholders and third persons, between shareholders and state bodies, between shareholders and company's officers (the members of board of directors, the director general, etc.). The Supreme Court of the RF has found that these cases fall within the jurisdiction of the courts of general jurisdiction.

Secondly, the meaning of some words and expressions contained in Article 33 is not clear. For example, the expression "the disputes, arising from the activity of the company" may be interpreted in different ways: as any commercial and business activity or as the activity in the sphere of corporate relations.

Thirdly, labour disputes are excluded from the jurisdiction of the commercial courts. These disputes fall within the competence of the courts of general jurisdiction. However labour disputes between a company and its top managers constitute an important part of corporate disputes and are closely connected with other corporate disputes.

The commercial court system is formed by four levels of courts. On the first level, all cases are handled by the court of first instance. The courts of the second level fully re-examine cases appealing against decisions handed down by the courts of first instance, which have not yet come into legal force. The third level is formed by the courts which check the legality of decisions handed down by the preceding courts with regards to the application of substantive and procedural law norms. The fourth level is represented by the Supreme Commercial Court of the Russian Federation, which is the supervisory level which re-examines cases in circumstances as provided for by Article 304 of the Code of Commercial Court Procedure of the RF.

---

[55] Grazhdanskii protsessual'nyi kodeks Rossiiskoi Federatsii ot 14.11.2002 No. 138-FZ published in Sobranie Zakonodatel'stva RF, 18.11.2002, No. 46, Pos. 4532.

2. Positivist judges or new approach towards construing statutes? How is the freedom of contract construed?

It will be useful to start with some general remarks on the principle of freedom of contract in civil law and on the principle of legality in procedural legislation. The Code of Commercial Court Procedure has several rules which clarify the role of written law in the Russian legal system. Article 6 of the Code of Commercial Court Procedure provides that according to the principles of Russian procedural legislation, every commercial court decision is legal and commercial courts shall apply all relevant legal material. According to Article 13 of the Code of Commercial Court Procedure, the commercial courts must settle legal disputes on the basis of the Constitution international treaties, laws and other statutes of the RF. Article 170 of the Code of Commercial Court Procedure obliges the judge to specify the laws and other legislative material applied in the decision. Moreover, the judge has to explain why other laws and legislative material were not applied although they were invoked by the parties to the dispute.

Today, judicial precedents are not formally regarded as a source of law[56]. This does not mean, however, that judges apply law in a "mechanistic manner". The power of a judge to interpret the law is a necessary condition of the application of law and the courts should play an active and independent role in the application of civil law[57].

Firstly, in resolving a case, a judge is to apply the general rules of law to specific circumstances. Any general provision of law is abstract.

Secondly, though the process of modernization and improvement of legislation is very wide, the quality of some of the new Russian laws still has room to improve. There are many gaps in the legislation and contradictions between laws. Often, Russian courts are obliged to create the law themselves.

When the statute is plain and unambiguous, the court must give effect to the intention of the legislature as expressed, rather than determine what the law should or should not be. When the rules in a statute are contradictory, or there is a gap in legislation, the courts should play an active and independent role in the application and interpretation of civil law. But interpreting the provisions of the Law on Joint Stock Companies and the Law on Securities Market is not an easy task for the courts. Often, it is more complicated to apply these laws than all other pieces of legislation in

---

[56] O.A. Ruzakova, in P.V. Krasheninnikov, ed., *Kommentarii k Arbitrazhnomu protsessual'nomu kodeksu* [Commentary on the Code of commercial process], Moscow 2007, Art. 13, p. 56.

[57] V.V. Molchanov, in M.K. Treushnikov, ed., *Arbitrazhnyi protsess* [Commercial process], Moscow 2007, p. 63.

Russia, a difficulty attributable to the foreign origin of both these laws. Sometimes the courts apply these laws to resolve several interrelated problems. The court first determine which point is governed by which law, and then contextualise this within the framework of the Russian civil law system These basic principles of civil legislation are determined in Chapter 1 of the Civil Code of the RF. The court must then seek to apply the provision in a manner which is consistent with the intention and goals of the legislature. Moreover, if possible, the court has to establish a basic set of general rules in accordance with the original law.

Precedent does not bind courts in the RF in the same way it does in Anglo-American jurisdictions. But the situation is changing, and now it cannot be denied that the judgments and other acts of the Supreme Commercial Court of the RF are expected to guide and significantly influence the practice of the lower courts. It should be clearly stated that this use of the Supreme courts of the Russian Federation in this way to create law is not the worst option, however the actions of the Supreme Commercial Court of the RF, which may be viewed as quasi-sources of law, are different.

On the one hand Supreme Commercial Court decisions relate to specific disputes. The Supreme Commercial Court of the RF settles some cases as a court of the first instance and renders judgments, which may contain interpretations of the law.[58] The Presidium of the Supreme Commercial Court of the RF reviews the acts of lower courts as a last instance and usually provides an explanation of the various rules of law in its decisions.[59] According to the decision of the Plenum of the Supreme Commercial Court of the RF N 17 dated 12 March 2007, the interpretation of any rule of law by the Supreme Commercial Court of the RF, in any decision, shall be viewed as a newly discovered fact and shall serve as the basis for a review of previous court decisions that were based on another interpretation of law. [60]

On the other hand, both the Plenum and the Presidium of the Supreme Commercial Court of the RF issue decisions containing the general explanations of statutes or their specific provisions.

This is carried out by studying and summarizing judicial practice and by the provision of appropriate explanations by the Plenum of the Supreme Commercial Court of the RF. The commercial courts must follow these

---

[58] Iarkov (*supra* note 49), p. 13.

[59] Iarkov (*supra* note 49), p. 6.

[60] Article 5.1 Postanovleniia Plenuma VAS RF ot 12.03.2007 No. 17 "O primenenii Arbitrazhnogo protsessual'nogo kodeksa Rossiiskoi Federatsii pri peresmotre vstupivshikh v zakonnuiu silu sudebnykh aktov po vnov' otkryvshimsia obstoiatel'stvam" published in Vestnik VAS RF, No. 4, April 2007.

explanations, for example, the decision of the "Plenum of the Supreme Commercial Court of the RF on Some Issues Concerning the Application of the Federal Law on Joint Stock Companies", dated 18 November 2002.

The Presidium of the Supreme Commercial Court of the RF also examines certain issues relating to the implementation of law by courts and gives some general recommendations or prepares a review of court practice. Although commercial courts are not formally bound by these recommendations, in practice they are obligatory.

The power of a court to interpret some rules of law is extremely important, especially when a dispute arises over a type of a contract not covered by the law.

As Article 1 of the Civil Code of the RF states, civil legislation is based on such basic principles as equality of the participants in civil relations, the inviolability of ownership, freedom of contract, the impermissibility of arbitrary interference by anyone in private affairs, the necessity for the unhindered realization of civil law rights, and ensuring the restoration of violated rights and their protection by the judiciary.

Citizens and legal entities receive and exercise their civil rights through their own will and in their own interest. They are free to establish their rights and duties in a contract and may determine any terms of that contract providing it is not contrary to legislation.

Article 421 of the Civil Code provides that citizens and legal persons are free to conclude a contract, and the parties may conclude a contract whether or not this is provided for by law or other legal material.

However freedom of contract is limited by some legal provisions. The most important is Article 422 of the Civil Code, which provides that a contract must comply with the mandatory rules of law established by law and other legal material (imperative norms) in effect at the time of its conclusion. These rules are obligatory for the parties of a contract. The majority of the rules of Law on Joint Stock Companies are mandatory rules. This means that any contract between shareholders, and the company charter itself must comply with these rules, and does not extend any obligation except to those who are party to it.

3. Relationship between judges, private practice and academia

There are different forms of relationships between judges, private practitioners and academic researchers. These relationships may be formal or informal, the interaction between judges and all other lawyers occurs in different spheres.

Firstly, the Code of Commercial Court Procedure provides that in the commercial court of first instance, cases are heard by a single judge, except for insolvency cases. But upon application of any party to a dispute,

the case can be heard by a judge with the participation of assessors from the commercial court (Article 19). The assessors exercise the same rights and bear the same duties as the judge.[61] According to Article 2 of the Law on Assessors of Commercial Courts[62] any citizen over the age of 25 who has an irreproachable reputation, higher professional education and experience working in the economic, financial, legal, managerial or entrepreneurial spheres for at least 5 years may become an assessor. The participation of assessors is especially important when specialized knowledge in the area of entrepreneurial and other economic activities is needed for the solution of a specific case.

Secondly, legal scholars and practicing lawyers participate in the process of preparing the recommendations and explanations of the Supreme Commercial Court.

One of the most important spheres of the activity of the Supreme Courts of the Russian Federation is to ensure the uniform understanding and application of the civil legislation by all courts[63]. The Supreme Commercial Court of the RF not only settles the cases in a supervisory capacity or as a court of the first instance, but also examines certain issues regarding the implementation of law by courts and gives recommendations and explanations. Usually drafts of all documents concerning the recommendations and explanations of some statutes or specific rules are first discussed by the judges of the Supreme Commercial Court and other lawyers from law firms, universities, legal research institutes in special meetings of the Presidium of the Supreme Commercial Court of the RF. In order to prepare relevant and valid recommendations concerning the application of laws and other normative acts as well as working out proposals for their improvement, a Scientific-Advisory Council has been formed at the Supreme Commercial Court. The Council is made up of sections dealing with procedural legislation, administrative law, civil law and international private law. The most experienced lawyers who practice law or conduct research in the legal sphere are members of this Council.

Moreover, cooperation between judges and other lawyers is very important in the drafting of legislation. Currently a large group of lawyers, including judges, is drafting the Guidelines concerning the development and improvement of civil legislation.

---

[61] Iarkov (*supra* note 49), p. 120.

[62] Federal'nyi zakon ot 30.05.2001 No. 70 (red. ot 29.06.2009) "Ob arbitrazhnykh zasedateliakh arbitrazhnykh sudov sub'ektov Rossiiskoi Federatsii" published in Sobranie Zakonodatel'stva RF, 04.06.2001, No. 23, Pos. 2288.

[63] M.K. Treushnikov, in M.K. Treushnikov, ed., *Arbitrazhnyi protsess* [Commercial process], Moscow 2008, p. 25.

2009: Russian Corporate Legislation Reform Continues and Has to Be Continued

OLEG ZAITSEV*

This article gives a short overview of the key changes to the Russian corporate legislation that were enacted in 2009: (1) the new version of the Federal Law "On Limited Liabilities Companies", (2) the "Anti-raid" Law, and the changes regarding (3) legal entities reorganization, (4) resolution of "deadlocks", (5) the liability of persons who control the legal entity in case of its bankruptcy, (6) shareholder agreements, (7) decrease of legal capital, and (8) contributions to company's legal capital by offsetting a claim against the company. This article also briefly outlines the prospects of further reform and new draft laws.

I. Introduction

Russian corporate legislation is now being reformed. Detailed grounds and proposals for the ongoing reform (the starting point was the enacting of the

* The views expressed in this article are the personal views of the author and do not represent the views of the Supreme Commercial Court of the Russian Federation.

Federal Law № 7-FZ of 5 January 2006[1,2]) can be found in the Conception of the Corporate Legislation Development for the Period through 2008[3] and in the Strategy of the Russian Federation Financial Market Development for 2006 – 2008[4,5]. The main reason for the reform is the need to solve a number of problems revealed in the practical application of Russian corporate legislation passed in the 1990's when there was lack of experience, in both the legislative regulation and the functioning of legal entities in a market economy. The main focus of the reform is concentrated on the perfection of the laws that regulate the two most widely-spread types of legal business entities in Russia – the joint stock company[6] (акционерное общество) (the Federal Law № 208-FZ of 26 December 1995 "On Joint Stock Companies"[7,8]) and the limited liability company[9]

---

[1] The Russian-language texts of this and all other federal laws mentioned in this article are available at <www.kremlin.ru/acts>. For the English-language texts of some of the Russian laws on legal entities see: Russian Company and Commercial Legislation. Compiled and edited, with translations from the Russian and an introduction, by W.E. Butler. Oxford; New York: Oxford University Press, 2003.

[2] This law introduced into the Russian corporate legislation the legal institutes of takeover and freeze-out of minority shareholders and to a large extent is based on the approaches of the Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids. For more on this law see: Глушецкий А.А., Степанов Д.И. "Вытеснение" и "поглощение": практический комментарий к новой главе акционерного закона. Москва, 2006.

[3] Approved by the Competitiveness and Entrepreneurship Council attached to the Office of the Government of the Russian Federation at 10 February 2006 (available at <www.nccg.ru/site.xp/050050055049124.html>).

[4] Approved by the Edict of the Government of the Russian Federation № 793-p of 1 June 2006 (available at <www.nccg.ru/site.xp/050056052051124.html>.

[5] See also general publications on the Russian corporate legislation reform: Авилов Г.Е., Суханов Е.А. Юридические лица в современном российском гражданском праве // Вестник гражданского права. 2006. № 1; Корпоративная реформа и гармонизация корпоративного законодательства России и ЕС/А. Астапович, О. Бестужева, Д. Вайнштейн, М. Гутброд, В. Дезер, К. Лёвушкина, В. Пыльцов. Москва, 2006 (available at <http://nccg.ru/en/site.xp/049048056056124049054052051.html>; Степанов Д.И. Трансформация корпоративного законодательства // Корпоративный юрист. 2006. № 2; Суханов Е.А. Перспективы корпоративного законодательства и другие проблемы отечественного права. Интервью с заведующим кафедрой гражданского права МГУ // Закон. 2006. № 9.

[6] Hereinafter referred to as JSC.

[7] Hereinafter referred to as JSC Law.

[8] For more information on this law: Black, Bernard S. Guide to the Russian Federal Law on Joint Stock Companies: Commentary and Material. Kluwer, 1998 (Russian-language version (Бернард Блэк, Рейнир Крэкман, Анна Тарасова. Комментарий Федерального закона "Об акционерных обществах"/Под общ. ред. А.С. Тарасовой. Москва: Издательство "Лабиринт", 1999) is available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=246670>.

(общество с ограниченной ответственностью) (the Federal law № 14-FZ of 8 February 1998 14-FZ "On Limited Liability Companies"[10])[11,12].

In 2009, reforms proceeded much more quickly – there were 7 laws passed making significant amendments to the Russian corporate legislation through the period from December 2008 to December 2009, mainly due to the global financial crisis. The passing of some of these laws was provided for by the Action Plan for Improvement of the Situation in the Financial Sector and Certain Sectors of the Economy (approved by the Chairman of the Government of the Russian Federation on 6 November 2008 № 4863п-П13[13]).

II. The New Version of the Federal Law "On Limited Liabilities Companies" (LLC law)

The Federal Law № 312-FZ of 12 December 2008 that came into effect on 1 July 2009 made significant amendments to the LLC Law to the extent that it actually created the new version of this law[14].

---

[9] Hereinafter referred to as LLC.

[10] Hereinafter referred to as LLC Law.

[11] The Conception of Corporate Legislation Development for the Period through 2008 says that according to the Consolidated State Register of Companies as of 1 October 2005 there were 2 681 973 legal entities, registered in Russia. Of these business (commercial) organizations – 2 012 425, which breaks down into LLCs – 1 668 814, JSCs – 185 361, general partnerships – 522, limited partnerships – 742, production cooperatives – 26177 and noncommercial organizations – 547 238.

[12] The basic features of the main types of legal business (commercial) entities in Russia are given in the addendum to the article.

[13] Available at <www.opora.ru/up/actual-documents/files/16552.0.pdf>.

[14] See about this law: Бевзенко Р.С. Новеллы законодательства о залоге долей в уставном капитале общества с ограниченной ответственностью // Меры обеспечения и меры ответственности в гражданском праве: Сборник статей / Рук. авт. колл. и отв. ред. М.А. Рожкова – Москва: Статут, 2010; Зайцев О.Р. Новая редакция Закона об ООО и антирейдерский закон: работа над ошибками // Закон. 2009. № 11; Могилевский С.Д. Новеллы законодательства об обществах с ограниченной ответственностью // Хозяйство и право. 2009. Приложение № 9; Новак Д.В. Приобретение ООО долей в своем уставном капитале в новых законодательных условиях // Корпоративный юрист. 2009. № 6; Новоселова Л.А. Новые положения законодательства об ООО: причины изменений и последствия // Хозяйство и право. 2009. № 3; Степанов Д.И. Корпоративная реформа // ЭЖ-Юрист. 12 May 2009 (available at <www.gazeta-yurist.ru/article.php?i=574>; Степанов Д.И. Реформа законодательства об ООО: к принципу свободы договора в корпоративном праве // Корпоративный юрист. 2009. № 6–7 (available at <www.epam.ru/articles/rus/Stepanov_KJ_June_2009.pdf>, <www.epam.ru/articles/rus/Stepanov_KJ_July_2009. pdf>.

The main novelty of the new version of LLC Law is a complication of the participant's interest in the capital (share) transfer process. According to article 21 (6) of the earlier version of the LLC Law, the transfer of a share could be executed in a simple written form (unless the company charter required that such transaction should be notarized) and the share passed to the acquirer at the moment the company was notified of the assignment. Now the share transfer transaction *must* be notarized and the share passes to the acquirer at the moment of the notarization (Article 21.(11)-(12) of the new version of LLC Law). The requirements to have share transfers notarized seeks to (1) prevent the alienation of shares without a shareholder's permission through counterfeited documents, (2) prevent the use of backdated shares transfer documents, (3) protect the acquirer of shares from double selling of shares by one seller to two different purchasers (According to article 21 (13) of the new version of the LLC Law it is necessary to present the notary with the text of the contract by which the assignor acquired the share and the notary makes a mark of the share transfer on this contract after notarizing the new transaction).

The same goals are pursued by changing the way share transfer records are entered into the Consolidated State Register of Companies. Previously, information about a company's shareholders and their individual shareholding was fixed in the company's charter. Changes were entered into the Consolidated State Register of Companies on application from the company's director by registering amendments to the charter made by a company's general shareholders meeting (Article 12 (2) and (4) of the earlier version of the LLC Law and Article 9 (1)(3) of the earlier version of the Federal Law № 129-FZ of 8 August 2001 "On the state registration of legal entities and individual businessmen"[15]). Following the reform, information about a company's shareholders is not included in the company's charter, with changes to this information are entered into the Consolidated State Register of Companies upon the application of the seller of the shares (Article 9 (1)(4) of the new version of the Federal Law "On the state registration of legal entities and individual businessmen").

An important peculiarity of the LLC (that distinguishes it from the JSC (joint stock company) according to the Russian law) is the right of every participant to withdraw unilaterally from the company at any time and receive his share in the company's net asset value. This right was previously unconditional (article 26 (1) of the earlier version of the LLC Law[16]), but now only exists if it is provided for by the company's charter

[15] The English-language text is available at <www.legislationline.org/documents/action/popup/id/4376>.

[16] As clarified in the paragraph 27 of the Resolution of the Plenum of the Supreme Court of the Russian Federation and the Plenum of the Supreme Commercial Court of the

(Article 26(1) of the new version of the LLC Law). Making withdrawal contingent on permission protects the company's financial stability. Those who value stability more than the opportunity to withdraw at any time may now choose this LLC type for their company[17].

An important element of the new version of the LLC Law is the introduction of regulation protecting shares from illegal alienation. The law now expressly provides for protection – a declaration of the right[18]. However, in the interest of civil circulation, the law imposes restrictions on the use of this defense by requiring: (1) a 3 year limitation period for claims and (2) a possibility of bona fide acquisition of the share (when the acquirer was unaware and could not have been aware that the seller had no right to alienate the share, unless the share was lost due to illegal acts of third parties or in another way contrary to his will) (Article 21 (17) of the new version of the LLC Law). It is easy to see that the idea and criteria for a bona fide share acquisition were borrowed from the rules protecting the bona fide acquisition of tangible property (Article 302 of the Civil Code of the Russian Federation[19,20]).

Russian Federation N 6/8 of 1 July 1996 "On some issues related to the implementation of the Part One of the Civil Code of the Russian Federation" (available at <www.supcourt.ru/vscourt_detale.php?id=940>), provisions of company foundation documents that deprive the participant of the right to withdraw or limiting this right must be qualified as void.

[17] For the reasons for changing the approach to the right to withdraw: Бевзенко Р.С. Выход участника из общества с ограниченной ответственностью: перспективы отмены // Закон. 2006. № 9; Новак Д.В. К вопросу об ограничениях на выход участника из общества с ограниченной ответственностью // Хозяйство и право. 2003. № 2; Стенограмма двенадцатого семинара по актуальным проблемам гражданского права "Ограничения на выход участника из ООО" (Российская школа частного права, 01 ноября 2002 г.) (available at <www.privlaw.ru/downloads/measures/seminars/seminar_01_11_2002.zip>).

[18] This method of protection was also used previously in judicial practice (see decisions of the Presidium of the Supreme commercial Court of the Russian Federation N 14106/06 of 27 February 2007, № 13999/06 of 6 March 2007, № 2913/09 of 30 June 2009, № 11458/09 of 17 November 2009 (these and all other commercial courts decisions mentioned in this article are available at <www.arbitr.ru>)), but at that time the issue was not expressly regulated by the LLC Law.

[19] The English-language text is available at <www.russian-civil-code.com>. See also: The Civil Code of the Russian Federation, edited and translated by Peter B. Maggs with A.N. Zhiltsov, Moscow, 1997; Russian Civil Code/Translation and Commentary by Christopher Osakwe, Moscow, 2000.

[20] It is no coincidence that with regard to the earlier version of the LLC Law, the Presidium of the Supreme Commercial Court of the Russian Federation admitted the appropriateness of action for declaration (recognition) of the right (share) treatment as a vindication with regard to articles 301, 302 of the Civil Code of the Russian Federation (Decision № 11458 of 17 November 2009).

III. Reorganization

Reform of the legislation governing the reorganization of legal entities was initially planned on a large-scale, the special law passed on reorganization provided for all aspects of this institution[21]. At the time, this was confined to specific amendments to laws currently in force dealing mainly with the protection of creditors during corporate reorganization; these amendments were enacted by the Federal Law № 315-FZ of 30 December 2008.

Under Russian law, reorganization is considered a case of universal legal succession[22] (Article 129 (1) of the Civil Code of the Russian Federation), to which the general limitations of singular legal succession are not applied (e.g. reorganization does not require creditor consent for the transfer a debt by the debtor to another person as prescribed by Article 391 (1) of the Civil Code of the Russian Federation[23]). This, on the one hand allows reorganization to be used as a mechanism for the relatively free redistribution of assets and liabilities, but on the other hand it poses a risk to creditors' rights by transferring debt to a company with fewer assets than the previous debtor in the process of reorganization.

A way of protecting creditors rights is provided by Article 60 (2) of the Civil Code of the Russian Federation which previously allowed the creditor of the reorganized legal entity to demand early performance by the debtor (discharge before the fixed date) of the obligation. This guarantee did not always work in practice, because its proper realization requires that the creditor was informed about the reorganization before it was completed. For this reason, Federal Law № 315-FZ of 30 December 2008 established that the company being reorganized should enter the relevant information into the Consolidated State Register of Companies and publish

---

[21] See the text of the initial draft at <www.lin.ru/document.htm?id=574508617227766494> and about it: Степанов Д.И. Заключение по проекту федерального закона "О реорганизации и ликвидации коммерческих организаций" (available at <www.lin.ru/document.htm?id=1249703346338427754>); Он же. Формы реорганизации коммерческих организаций: вопросы законодательной реформы // Хозяйство и право. 2001. №3 <www.hozpravo.ru/archive/2001/2001_3.pdf>; the verbatim record of discussing this draft on the meeting of the Civil Legislation Codification and Perfection Council attached to the Office of the President of the Russian Federation and the opinion letter of this Council about this draft (Вестник гражданского права. 2007. № 1) (the text of the opinion letter is also available at <http://www.privlaw.ru/files/2006.zip>).

[22] See e.g.: Черепахин Б.Б. Правопреемство по советскому гражданскому праву (§ 1 "Универсальное правопреемство при реорганизации юридических лиц" главы 3) // Труды по гражданскому праву. Москва: Статут, 2001 (available at <http://civil.consultant.ru/elib/books/22/page_31.html#35>).

[23] See: the decision of the Supreme Commercial Court of the Russian Federation N 11890/06 of 24 October 2006; Зайцев О.Р. К вопросу об обоснованности признания преобразования формой реорганизации // Цивилист. 2005. № 2.

the notice about its reorganization twice, with a one month interval in between (current Article 60 (1) of the Civil Code of the Russian Federation). On the other hand, the general wording and lack of limitations contained in article 60 (2) of the Civil Code of the Russian Federation could endanger the reorganization where the debts to be paid in advance were too high. Because of this, the Federal Law № 315-FZ of 30 December 2008 introduced several limitations for creditors. The general limitation provided that the creditor may demand early performance only if this right arose before the reorganization notice was published (current Article 60 (2) of the Civil Code of the Russian Federation). The next limitation (current Article 60 (3) of the Civil Code of the Russian Federation) provides that the creditor of the open JSC being reorganized by merger, affiliation or transformation may demand early performance where the company, its participants or third parties did not give sufficient guarantees to ensure performance of the company's obligation. This demand can be raised by the creditor no later than 30 days after publication of the reorganization notice; furthermore the raising of such a demand by creditors does not stop the reorganization process. The Federal Law № 315-FZ of 30 December 2008 established even further limitations for creditors of credit organizations: according to the new version of Article 23(5) of the Federal Law № 395-1 of 2 December 1990 "On banks and banking operations", creditors of a bank may demand early performance where a bank goes through reorganization only if the right to raise such a demand was provided for by the contract between the creditor and the bank.

IV. The Liability of Persons who Control the Legal Entity in Bankruptcy

The basic rule of Russian corporate legislation is that the founder of the legal entity shall not be liable for the legal entity's obligations (Article 56 (3) of the Civil Code of the Russian Federation). But this Article also contains an exemption – the bankruptcy of a legal entity through the fault of its participants. The Federal Law N 73-FZ of 28 April 2009[24] made significant amendments to the grounds and the procedure for holding participants liable for company debt in cases of bankruptcy. This law introduced a new term– "controller" (person who monitors or audits the legal entity). The controller is a person who has (or had during two or less years before the bankruptcy proceeding started), the right to give mandatory directions to

[24] For more on this law see: Цыганков С.Н. За здоровье должника и в защиту кредитора // ЭЖ-Юрист. 2009. № 23 (available at <www.gazeta-yurist.ru/article.php?i=626>.

the debtor or who had the opportunity to determine the debtor's activity in another way (Article 2 of the Federal Law № 127-FZ of 26 October 2002 "On Insolvency"[25]) – for example, the shareholder with more than a half of all issued shares can be regarded as a controller. According to Article 10 (4) of the above-mentioned law, the controllers can, under certain conditions, be held jointly liable for debts; furthermore the insolvency administrator has the power to render them liable as part of the insolvency process, removing the need for an external suit[26].

V. Shareholder agreements

Russian corporate legislation did not expressly regulate "shareholders agreements" until quite recently; several arbitration court decisions had declared these agreements void[27], casting the possibility of concluding such agreements in doubt.[28]. For this reason, in 2009, the legislator expressly introduced the right to conclude such agreements both in the JSC Law (shareholders agreement – Article 32.1, introduced by the Federal Law N 115-FZ of 3 June 2009) and in the LLC Law (contract on exercise of participants' rights –Article 8 (3), introduced by the Federal Law N 312-FZ of 30 December 2008)[29]. While the LLC Law only provides the term

---

[25] English-language text (the version before the amendments) is available at <www.nordvastraryssland.se/filestore/127FZ.23.html>.

[26] The Federal Law № 73-FZ also made a corresponding amendment to the Federal Law № 40-FZ of 25 February 1999 "On insolvency (bankruptcy) of credit organizations" (English-language text (the version before the amendments) is available at <www.asv.org.ru/en/legislation/law_2/>.

[27] See the decisions of the Federal Arbitration Court of the Western-Siberian Area of 31 March 2006 for the case N A75-3725-Г/04-860/2005, Moscow City Arbitration Court of 13 March 2008 for the case N A40-68771/07-81-413 and of 26 December 2006 for the case N A40-62048/06-81-343.

[28] See further about the Russian court practice before the Federal Law N 115-FZ of 3 June 2009 and its perception by legal society: Степанов Д.И. Соглашения акционеров в российской судебной практике // Корпоративный юрист. 2008. № 9.

[29] See further about these new developments: проект Федерального закона "О внесении изменений в Гражданский кодекс Российской Федерации и Федеральный закон 'Об акционерных обществах' (в части регулирования акционерных соглашений)", стенограмма заседания и экспертное заключение Совета при Президенте Российской Федерации по кодификации и совершенствованию гражданского законодательства по данному законопроекту // Вестник гражданского права. 2008. № 1 (заключение также доступно по адресу <www.privlaw.ru/files/2007.zip>); Письмо Министерства экономического развития Российской Федерации от 14 September 2009 N Д06-2643 "О разъяснении изменений, внесенных в Федеральный закон 'Об акционерных обществах', в части регулирования института акционерных соглашений" (available at <www.economy.gov.ru/minec/activity/sections/CorpManagment/

and allows shareholders to make such an agreement, the JSC Law provides detailed regulation.

The main problem with shareholders agreements is the difficulty in protecting the parties in case of violation. The JSC Law presumes that the shareholder agreement is obligatory only for its parties, but while the violation of this agreement does not entitle a party to challenge a decision of the company's decision making bodies, at the same time a contract concluded in contradiction with the shareholders agreement can be declared invalid by the court. This court declaration requires the claimant party to demonstrate that the partner to the contract knew, or obviously should have known about the limitations provided for by the shareholders agreement (Article 32.1(4)). Furthermore, according to subsection 7 of the same article, the rights of parties to create a shareholders agreement (including the right to demand for damages compensation, the exaction of a penalty, fixed sum of compensation payment) should be protected by the court. With respect to fixed sum compensation, the initial draft law had proposed a derogation from the general rule of Article 333 of the Civil Code of the Russian Federation (allowing the court to reduce the sum of the penalty clearly disproportionate to the consequences of the violation of an obligation). This proposal was rejected because of the legal stance of the Constitutional Court of the Russian Federation which characterizes the possibility of reducing a penalty sum as a legitimate instrument to stave off an abuse of the freedom to fix a penalty (i.e. in essence to fulfill the requirement of subsection 3 Article 17 of the Constitution of the Russian Federation[30] that the exercise of the rights and freedoms of man and citizen shall not violate the rights and freedoms of other people, decision № 263-O of 21 December 2000[31]). It is also necessary to note that under certain circumstances the JSC Law requires disclosure of a shareholders agree-

---

doc40000010>; Ломакин Д.В. Договоры об осуществлении прав участников хозяйственных обществ как новелла корпоративного законодательства // Вестник Высшего Арбитражного Суда Российской Федерации. 2008. № 9; Плеханов В. Договоры участников общества с ограниченной ответственностью // Корпоративный юрист. 2006. № 9 (available at <www.epam.ru/articles/rus/Plehanov_KJ_June_2009.pdf>; Распутин М. Договор об осуществлении прав участников ООО как инструмент защиты интересов миноритариев // Корпоративный юрист. 2008. № 9 (available at <www.epam.ru/articles/rus/Rasputin_clj_august2009.pdf>); Шаститко А.Е. Соглашения между акционерами: круг вопросов и подходы к исследованию. Бюллетень Бюро экономического анализа. 2006. № 81 (available at <www.beafnd.org/common/img/uploaded/Bulletin_81.pdf>).

[30] English-language text is available at <www.constitution.ru/en/10003000-01.htm>.

[31] See экспертное заключение Совета при Президенте Российской Федерации по кодификации и совершенствованию гражданского законодательства.

ment. This may be of relevance for considering the question of whether the person should have known about the agreement (Article 32.1 (5) and (6)).

VI. "Deadlocks"

The absence of solutions to "deadlocks" in the Russian corporate legislation[32] (situations when the participants cannot agree on important questions concerning the company, e.g. when there are two participants in the company each of whom holds half of all shares), did not, of course, mean that such situations did not appear in practice.

One of the most frequent deadlock situations in the JSC is board member inability to make a decision that requires a qualified quorum or majority vote (e.g. two thirds of its members)[33]; this problem becomes especially important when the board of directors cannot elect a general director. That is why the Federal Law № 115-FZ of 3 June 2009 also established a special mechanism for resolving this situation. Now according to Article 69 (5) and (6) of the JSC Law if the decision to elect the general director has not been made by the board of directors at two successive meetings or within 2 months after termination of previously elected general director powers, than the question of election can be transferred through a special procedure to the general shareholders' meeting.

---

[32] One of rare examples of the Russian legislator's attention to similar situations is Article 79 (2) of the JSC Law that provides in the case when unanimity of the board of directors members on the question of approving a major transaction is not achieved, upon the board's decision this question resolution can be transferred to the general shareholders meeting.

[33] The possibility of introducing these qualified requirements is provided for by Article 68 (2) and (3) of the JSC Law. There is no such problem for the general shareholders meeting because the JSC Law does not allow an increase the requirements for a quorum nor for majority vote as it regulates these matters imperatively (Article 49(2) and Article 58(1)). In a determinate sense this approach can be regarded as directed preventing the possibility of deadlocks at the level of general shareholder meeting. In this connection it is interesting to mention that the LLC Law by contrast allows the company's charter to increase to include the requirements for the general shareholders meeting majority vote (Article 37(8)) and therefore in LLCs, deadlocks at the level of the general meeting do take place. Furthermore there is a different court practice on the matter where the company's charter provides for unanimous voting at the general shareholders meeting (see Марьянков А. Проблемы единогласия участников на общем собрании общества с ограниченной ответственностью // Корпоративный юрист. 2008. № 8).

VII. "Anti-raid" law

An important part of reforming the Russian corporate legislation is enacting the so-called "Anti-raid" law (the Federal Law № 195-FZ of 19 July 2009) whose unofficial name is derived from its main aim of preventing "corporate raids" (i.e. illegal gaining of control over the company or its assets)[34].

The numerous amendments to the legislation made by the Anti-Raid Law can be divided into two large groups. The first group consists of amendments aimed at perfecting the procedure of resolving corporate disputes in arbitration courts[35]. This was achieved by making significant amendments to the Arbitration Procedural Code of the Russian Federation. Among the main procedural developments we should mention: (1) the introduction of a new chapter 28.1 regulating peculiarities of resolving corporate disputes that include in particular (a) exclusive jurisdiction of the regional arbitration court where the company is registered for corporate disputes[36] (Article 38 (4.1)), (b) the duty of the arbitration court to notify the legal entity (the company) about a pending case even if this legal entity is not a party to this case (Article 225.4), (c) a court procedure of calling a general shareholders meeting in JSC (Article 225.7), (2) the introduction of a procedure for consideration of "class actions" (Chapter 28.2) that can be used also for corporate disputes, (3) the enhancement of court's right to join some separate cases into one, to reduce the risk of rendering inconsistent decisions (Article 130).

The other group of amendments consists of amendments to substantive legislation and also deals with corporate disputes. Among them we should mention: (1) establishing the cases of nullity of corporate decisions in the statute (e.g, when there was no quorum to make a decision) (Article 40 (10) of the JSC Law and Article 43 (6) of the LLC Law)[37], (2) establishing the

---

[34] See: Степанов Д.И. Про опционы, дедлоки и интерпренерский дух // ЭЖ-Юрист. 2009. № 28 <www.gazeta-yurist.ru/article.php?i=693>.

[35] See: Приходько И.А., Бондаренко А.В., Столяренко В.М. Комментарий к изменениям, внесенным в Арбитражный процессуальный кодекс Российской Федерации Федеральным законом от 19 июля 2009 г. №205-ФЗ. Москва, 2009; Рожкова М.А. Корпоративные отношения и возникающие из них споры // Вестник Высшего Арбитражного суда Российской Федерации. 2005. № 9; Степанов Д.И. Корпоративные споры и реформа процессуального законодательства // Вестник Высшего Арбитражного Суда Российской Федерации. 2004. № 2.

[36] For the reasoning behind this idea: Новак Д.В. Подсудность корпоративных споров в России и за рубежом // Вестник Высшего Арбитражного Суда Российской Федерации. 2004. № 6.

[37] As a general rule the legislation considers decisions made with violations of the law as voidable, i.e. they should be declared invalid by a court upon a special suit. Before

grounds for dismissal of a claim challenging major deals and interested-party transactions (e.g. in case of counterparty's good faith – when he did not know and could not have known that the transaction was concluded in violation of the law) (Article 79 (6) and Article 84 (1) of the JSC Law, Article 45 (5) and Article 46 (5) of the LLC Law)[38], (3) introduction of joint liability for the JSC and the registrar (the special professional company that keeps the register of shares) for the damages suffered by a shareholder caused by improper share register keeping (e.g. when the shares were illegally transferred to another person) (Article 44 (4) of the JSC Law)[39].

---

the Anti-Raid Law the courts' practice also acknowledged that in some cases, these decisions must be regarded as void (Article 24 of the Resolution of the Plenum of the Supreme Court of the Russian Federation and the Plenum of the Supreme Commercial Court of the Russian Federation N 90/14 of 9 December 1999 "On some issues of application of the Federal Law 'On Limited Liability Companies'" (available at <www.supcourt.ru/vscourt_detale.php?id=985>) and Article 26 of the Resolution of the Plenum of the Supreme Commercial Court of the Russian Federation N 19 of 18 November 2003 "On some issues of application of the Federal Law 'On Joint Stock Companies'" (available at <www.legis.ru/misc/doc/3264/>). See further on this matter: Степанов Д.И. Ничтожность решений общих собраний акционеров // Корпоративный юрист. 2005. № 1.

[38] Most of these grounds (including a counterparty's good faith) were previously acknowledged by court practice (see article 20 of the Resolution of the Plenum of the Supreme Court of the Russian Federation and the Plenum of the Supreme Commercial Court of the Russian Federation N 90/14 of 9 December 1999 and the Resolution of the Plenum of the Supreme Commercial Court of the Russian Federation N 40 of 20 June 2007 "On some issues of application of legislation concerning interested-party transactions" (available at <www.kadis.ru/texts/index.phtml?id=22170>). See further: Зайцев О.Р. Комментарий к Постановлению Пленума Высшего Арбитражного Суда Российской Федерации от 20. June 2007 № 40 // Практика рассмотрения коммерческих споров: Анализ и комментарии постановлений Пленума и обзоров Президиума Высшего Арбитражного Суда Российской Федерации. Выпуск 9. Под ред. Л.А. Новоселовой, М.А. Рожковой. Москва: Статут, 2009; Маковская А.А. Комментарий к постановлению Пленума Высшего Арбитражного Суда РФ от 20 June 2007 № 40 "О некоторых вопросах практики применения положений законодательства о сделках с заинтересованностью" // Хозяйство и право. 2008. № 3.

[39] Previously the law did not provide for joint liability of the registrar and the JSC was the only one liable (see e.g. the Decision of the Supreme Commercial Court of the Russian Federation N 16112/03 of 2 August 2005). See further about this problem: Кокорев Р.А., Шаститко А.Е. Оценка регулирующего воздействия "Распределение прав и ответственности при хищении бездокументарных ценных бумаг". Бюллетень Бюро экономического анализа. 2006. № 77 (available at <www.beafnd.org/common/img/uploaded/Bulletin_77.pdf>); Ломакин Д.В. Правовые проблемы определения субъектов ответственности за необоснованное списание акций // Вестник ВАС РФ. 2007. № 9; Степанов Д.И. Ответственность эмитента и регистратора за необоснованное списание акций // Вестник ВАС РФ. 2007. № 3.

VIII. Decreasing Legal Capital

The same problems described above concerning the protection of creditors rights in corporate reorganizations were, until recently, caused by the rule stipulating that when the JSC decides to decrease its legal capital, creditors are entitled to demand early performance (the earlier version of Article 30 (1) of the JSC Law). Because of this, the Federal Law N 352-FZ of 27 December 2009 made amendments using the same approach as the Federal Law № 315-FZ of 30 December 2008 mentioned above. Now according to the new version of Article 30 of the JSC Law, a JSC planning to decrease its legal capital must record it in the Consolidated State Register of Companies and publish a notice about this decision twice, with a one month interval. The creditor may demand early performance only if his right arose before notice was published, furthermore the court may dismiss this action if the company proves that the decrease in legal capital does not violate creditor's rights or that the guarantees for performance are sufficient.

In addition, the JSC is obliged to decrease its legal capital where the net asset value of the company becomes lower than its legal capital (the earlier version of Article 35 (4) of the JSC Law). Because of this, the Federal Law N 352-FZ of 27 December 2009 also made amendments according to which: (1) information about the net asset value of the JSC is now entered into the Consolidated State Register of Companies and must be regularly updated (Article 5(1)(f) of the Federal Law № 129-FZ of 8 August 2001 "On the state registration of legal entities and individual businessmen"), (2) in some cases, creditors are entitled to demand early performance where the net asset value becomes less than the legal capital itself without waiting for a decision to decrease legal capital (Article 35 (9) of the JSC Law).

IX. Contribution to a Company's Legal Capital by Offsetting a Claim Against the Company

Until recently, Russian corporate legislation prohibited making contributions to a company's legal capital by means of offsetting a claim against the company (Article 90 (2) and Article 99 (2) of the Civil Code of the Russian Federation). The Federal Law N 352-FZ of 27 December 2009 partially removed this restriction by establishing that (1) supplementary paying up of shares by offsetting a claim against the company is allowed where shares are being placed by closed subscription (new version of Article 34 (2) of the JSC Law), and that (2) shareholders may make additional contributions to a company's legal capital by offsetting a claim

against the company by unanimous decision of the general shareholders meeting (new version Article 19 (4) of the LLC Law)[40].

X. To be continued…

Though the above-listed numerous amendments to different pieces of legislation were significant steps forward in reforming Russian corporate legislation, this reform is far from being finished. Further reform prospects are primarily connected with the ongoing general process of the Russian civil legislation development that began in 2008[41]. The Conception of the Legal Entities Legislation Perfection was prepared as part of this process[42], and the main ideas of this Conception were included in the general Conception of Development of the Civil Legislation of the Russian Federation[43]. Among the main ideas for improving the corporate legislation suggested in the Conception we should mention: (1) the introduction of a protection of trust in the Consolidated State Register of Companies (that should protect those who faithfully relied upon the authenticity of the Register's data, where this data should later turn out to be false), (2) the introduction of control over the legality of foundation document contents as part of registering a company, (3) the increase of the minimal amount of legal capital for JSC and LLC.

There are also several pending draft laws on further Russian corporate legislation development, including areas such as: (1) liability of managers (including members of board of directors)[44], (2) bankruptcy proceedings

---

[40] See: Григорьев М. "Зачетная" реструктуризация долга: институт debt-for-equity swap в России // ЭЖ. Юрист. 28 January 2010 (available at <www.gazeta-yurist.ru/article.php?i=971>).

[41] This process was implemented on the basis of the Decree of the President of the Russian Federation № 1108 of 18 July 2008 "On perfection of the Civil Code of the Russian Federation" (available at <www.privlaw.ru/index.php?section_id=22>). See also: Маковский А.Л. О Концепции развития гражданского законодательства Российской Федерации // Концепция развития гражданского законодательства Российской Федерации. Москва: Статут, 1999.

[42] Recommended by the Civil Legislation Codification and Perfection Council attached to the Office of the President of the Russian Federation for publishing (minutes № 68 of 16 March 2009) (available at <www.privlaw.ru/files/concep_11_2009.doc>).

[43] Approved at the meeting of the Civil Legislation Codification and Perfection Council attached to the Office of the President of the Russian Federation on 7 October 2009 (available at <www.privlaw.ru/concepciya.rtf>).

[44] Проект федерального закона "О внесении изменений в отдельные законодательные акты Российской Федерации" (в части привлечения к ответственности членов органов управления хозяйственных обществ) (available at <www.fcsm.ru/document.asp?ob_no=208531>).

for corporate groups,[45] (3) affiliated persons, major deals and interested-party transactions.[46]

[45] Проект Федерального закона "О внесении изменений в Федеральный закон "О несостоятельности (банкротстве)" и иные законодательные акты Российской Федерации в части совершенствования реабилитационных процедур" (available at <www.economy.gov.ru/wps/wcm/connect/economylib4/mer/resources/649c5f80412bcd6ba456b45f2a6ba6b3/proekt_fz_o_bankrotstve.rar>).

[46] Проект Федерального закона "О внесении изменений в Гражданский кодекс Российской Федерации, Федеральный закон "Об акционерных обществах" и некоторые другие законодательные акты Российской Федерации" (available at <www.economy.gov.ru/minec/activity/sections/CorpManagment/doc20100210_04>).
See: Макеева Е. Сделки с усложненной процедурой заключения: форма vs. содержание // Корпоративный юрист. 2007. № 1.

The basic features of the main types of legal commercial entities in Russia

<table>
<tr><td colspan="2"><u>Aktsionernoje obshestvo/ акционерное общество– АО</u>
(≈ joint stock company in USA, ≈ Aktiengesellschaft in Germany)</td><td><u>Obshestvo s ogranichennoj otvetstvennostju / общество с ограниченной ответственностью – ООО</u>
(≈ LLC in USA, ≈ GmbH in Germany, ≈ BV in the Netherlands,)</td></tr>
<tr><td colspan="3">The company must be registered in the trade register kept by the State Tax Authority</td></tr>
<tr><td colspan="3">Notarized form of company establishment is not obligatory</td></tr>
<tr><td colspan="3">Liability of participants (shareholders) for company's debts is limited to their contributions to company's capital</td></tr>
<tr><td colspan="3">Shares are undocumented, no paper certificates</td></tr>
<tr><td colspan="2">Shares are tsennyje bumagi/ценные бумаги (≈ Wertpapiere in Germany, ≈ securities in USA)</td><td>Shares are not tsennyje bumagi,
they are simple rights</td></tr>
<tr><td colspan="2">Information about shareholders (names of persons and number of shares) is not recorded in the trade register, but it is recorded in the register of shareholders kept by the company itself or by a special licensed professional company (if total number of shares issued by the company exceeds 50 then the register of shareholders must be kept by such a professional)</td><td>Information about shareholders (names of persons and number of shares) is recorded in the trade register</td></tr>
<tr><td colspan="2">Notarized form of shares transfer is not obligatory</td><td>Notarized form of shares transfer is obligatory, otherwise the transfer is void.</td></tr>
<tr><td colspan="2">The purchaser becomes the shareholder only after recording the shares transfer in the register of shareholders</td><td>The purchaser becomes the shareholder in the moment of notarial attestation of shares transfer. After that the notary gives this information to trade register</td></tr>
<tr><td><u>Otkrytoje AO/открытое АО – ОАО</u>
(≈ open joint stock company in USA, ≈ NV in the Netherlands)</td><td><u>Zakrytoje AO/закрытое АО – ZAO</u>
(, ≈ closed joint stock company in USA, ≈ BV in the Netherlands)</td><td></td></tr>
<tr><td>The number of shareholders is not limited</td><td colspan="2">The number of shareholders must not exceed 50</td></tr>
<tr><td>Shares can be traded on stock exchanges</td><td colspan="2">Shares can not be traded on stock exchanges</td></tr>
<tr><td>Shares can be absolutely freely transferred to anyone</td><td colspan="2">If one shareholder wants to sell his shares to a third person (not another shareholder), then he is obliged to offer his shares to the other shareholders first (preemption right)</td></tr>
<tr><td colspan="2">The company's charter can not prohibit or limit (contingent on shareholder approval) shares transfer to a third person (not another shareholder)</td><td>The company's charter can provide that shares transfer to a third person (not another shareholder) is prohibited or is possible only with previous approval of other shareholders</td></tr>
<tr><td colspan="2">The company's charter may not provide that a shareholder may at anytime withdraw from the company</td><td>The company's charter may provide that a shareholder may at anytime withdraw from the company</td></tr>
</table>

Recent Company Law Developments in the European Union*

IONUȚ RĂDULEȚU

I. Introduction

The process of harmonizing company law in the European Union started more than forty years ago. Since then, the volume of European company law has grown steadily, to include a set of directives, as well as various regulations and recommendations. These deal mainly with company publicity, minimum capital, mergers and divisions, branches, accounting and audit issues, company forms, remuneration and independence rules for directors etc. The European Commission abandoned the idea of full harmonization in favour of specific measures for some critical areas. It should also be mentioned that in recent years, the attention of the European legislator has shifted from an initial interest in substantive company law to address corporate governance and capital market related issues. Academia and company law practitioners in Member States were also involved in the development of this integration process.[1] In this context, in 2001, the Com-

* The author would like to thank Rainer Kulms for his useful comments on a previous version of this paper.

[1] See *Hopt*, Comparative Company Law, ECGI – Law Working Paper No. 77/2006, p. 1174 and the following (available at SSRN: <http://ssrn.com/abstract=980981>; *Enriques/Gelter*, Regulatory Competition in European Company Law and Creditor Pro-

mission convened the High Level Group of Company Law Experts[2], whose reports prepared the ground for the Company Law Action Plan of the European Commission of May 2003[3]. The Action Plan was a European reaction to the US Sarbanes-Oxley Act of 2002 and primarily addressed corporate governance concerns. In addition to that, the Action Plan also considered such issues as capital maintenance and alteration, groups and pyramids, corporate restructuring and mobility or the European Private Company[4]. The main policy objectives of the Commission were the strengthening of shareholders rights and third party protection, as well as the fostering of efficiency and competitiveness of businesses inside the EU.[5] The measures proposed by the Action Plan were scheduled for the short term (2003−2005), medium term (2006−2008) and long term (2009 onwards). An Advisory Group made up of twenty non-governmental experts was set up by the Commission in 2005, to provide regular technical advice on the planned corporate governance work[6]. Simultaneously, the European Corporate Governance Forum was established, chaired by the Commission and made up of representatives from the Member States, from

---

tection, in: Eidenmüller/Schön (eds.), The Law and Economics of Creditor Protection – A Transatlantic Perspective (The Hague, 2008), 421 et seq.; *Grundmann*, Europäisches Gesellschaftsrecht, (Heidelberg 2004), 27 et seq.

[2] Report of the High Level Group of Company Law Experts (Chairman Jaap Winter, Other Members: Hopt/Rickford/Rossi/Schans/Christensen/Simon; Rapporteur: Thienpont) on Issues Related to Takeover Bids of 10 January 2002 <http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf> and the Report of the same Group on a Modern Regulatory Framework for Company Law in Europe of 4 November 2002 <http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf>.

[3] Communication to the Council and the European Parliament, Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, 21 May 2003, COM (2003) 284 final <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0284:FIN:EN:PDF>.

[4] On the European Private Company and Partnership Law Reform in the European Union cf. *Zaman/Schwarz/Lennarts/de Kluiver/Dorresteijn* (eds.), The European Private Company (SPE) – A Critical Analysis of the EU Draft Statute, Antwerp 2009; and the volume by *McCahery/Timmerman/Vermeulen* (eds.), Private Company Law Reform – International and European Perspectives, The Hague 2010.

[5] Although the European Commission officially made a plea for a more flexible regulatory framework for businesses in Europe compared to the intensive regulation undertaken in US after the Enron corporate scandal, there are authors who consider the EU approach itself as rather reactive or even over-reactive, thus only leading to an increased regulatory burden for European companies. See e.g. *Lanoo/Khachaturyan*, Reform of Corporate Governance in the EU, European Business Organization Law Review (EBOR), 5 (2004), p. 37, and *Enriques*, Company Law Harmonization Reconsidered: What Role for the EC?, in: Bartman (ed.), Kluwer Law International, 2006, p. 59 et seq.

[6] See Commission Decision of 28 April 2005 establishing a group of non-governmental experts on corporate governance and company law (2005/380/EC), OJ L 126/40 of 19 May 2005.

industry (European regulators, issuers and investors) and from academia, having as its main task the coordination of national corporate governance codes and principles[7].

In 2006 the Commission organized a public consultation to reassess the Action Plan and it subsequently set some new priorities in an effort to simplify the regulatory environment for European businesses and to react to complaints of regulatory fatigue from the market.[8] A new communication was published in 2007, outlining a series of proposals to simplify the *acquis communautaire* in the fields of company law, accounting and auditing. In the context of the current financial crisis, the Commission was forced to reconsider its policy in the area of financial supervision. The new measures proposed in this regard by the *de Larosière* report from February 2009 concern both the general European financial supervision architecture[9] and the areas of company law and corporate governance (redefining the role of board members, reforming risk management procedures, internal controls and accounting standards, reconsideration of management bonus policies in the financial sector, better supervision of credit rating agencies etc.).[10]

II. Simplifying the Business Environment for Companies

The issue of administrative costs associated with regulation is of central importance for European law-making, which adds an upper regulatory level to national legislation in EU Member States. This is particularly relevant for business companies, which have to comply with both national and European rules in their activity and bear the corresponding administrative burdens. On the other hand it is clear from the outset that company law belongs to the most ancient areas of law harmonized at the European level, with the First Directive[11] dating from 1968, whereas the business environ-

---

[7] See speech by the then EU Commissioner for Internal Market and Services *McCreevy*, Corporate Governance in Europe, Brussels, 20 January 2005 (SPEECH 05/26) <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/26&format=HTML&aged=0&language=EN&guiLanguage=en>.

[8] *Baums*, European Company Law Beyond the 2003 Action Plan, European Business Organization Law Review (EBOR) 8 (2007), 143 et seq.

[9] *Iglesias-Rodriguez*, Towards a New European Financial Supervision Architecture, Columbia Journal of European Law Online, Vol. 16, No. 1, 2009 (available at SSRN: <http://ssrn.com/abstract=1518062>.

[10] *Stefou*, Does the Financial Crisis Teach Us Anything About Corporate Governance? (29 September 2009). Available at SSRN: <http://ssrn.com/abstract=1480224>.

[11] First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of

ment has meanwhile changed dramatically. To address these issues, in July 2007, the European Commission published a Communication on a simplified business environment for companies in the areas of company law, accounting and auditing[12].

First of all a differentiation was made between Union norms which address mainly domestic situations and Union norms aimed mainly at solving specific cross-border problems. In the first case, the question was whether the restrictions imposed by those norms really needed to be determined at EU level and not at national level. This concerns for instance the Third[13] and Sixth[14] company law Directives on domestic mergers and divisions or the Second[15] and Twelfth[16] Directives. The alternative for the Commission was to either entirely repeal these directives or to just simplify them in order to substantially reduce administrative burdens. The simplification was also at issue for the disclosure requirements in the First and Eleventh[17] company law Directives. As regards the norms addressing cross-border problems, they were to take a central position in Union law-

---

the Treaty, with a view to making such safeguards equivalent throughout the Community (OJ L 65/8 of 14 March 1968). On 21 October 2009 the First Company Law Directive was repealed and codified by Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent (OJ L 258/11 of 1 October 2009, p. 11).

[12] COM(2007) 394 final, Brussels, 10 July 2007 <http://ec.europa.eu/internal_market /company/docs/simplification/com2007_394_en.pdf>.

[13] Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies (OJ L 295/36 of 20 October 1978).

[14] Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty concerning the division of public limited liability companies (OJ L 378/47 of 31 December 1982).

[15] Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (OJ L 26/1 of 31 January 1977).

[16] Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies (OJ L 395/40 of 30 December 1989). On 21 October 2009 the Twelfth Company Law Directive was repealed and codified by Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies (OJ L 258/20 of 1 October 2009).

[17] Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State (OJ L 39536 of 30 December 1989).

making. In the responses received from stakeholders to its communication, the Commission gathered support for the option of simplification of the *acquis*, to the detriment of its repeal.[18] The *acquis* provides legal certainty and its repeal would only increase the costs of doing business in the EU.

According to these reactions from the public, the Commission proceeded in April 2008 with a proposal [COM(2008)194] to amend the First and Eleventh Directives (the obligation to publish business data in the national gazette was abolished, costs of the translation obligations when opening branches in other Member States were diminished etc.)[19], as well as the Fourth and Seventh Directives[20]. In September 2008 this was followed by a proposal for a modification of the Third and Sixth Directives (reducing reporting requirements for shareholders' decisions, avoiding double reporting under EU norms, use of Internet and electronic mail for informing shareholders etc.).[21]

Apart from these measures aimed at reforming classical company law directives, the Commission initiated a separate policy in favour of small and medium-sized enterprises (SMEs). Its main element is the Small Business Act (SBA) for Europe, published on 25 June 2008[22], which proposes a "think small first" approach. According to this, public policy tools should be adapted to SMEs needs, access to finance should be facilitated for SMEs, entrepreneurship and innovation should be rewarded, SMEs should

---

[18] See European Commission, The Internal Market and Services Directorate-General, Synthesis of the Reaction Received to the Commission Communication on Simplified Business Environment for Companies in the Areas of Company Law, Accounting and Auditing (COM(2007) 394), Brussels, December 2007 <http://ec.europa.eu/internal_market/company/docs/simplification/consultation_report_20071219_en.pdf>.

[19] Proposal for a Directive of the European Parliament and the Council amending Council Directives 68/151/EEC and 89/666/EEC as regards publication and translation obligations of certain types of companies <http://eur-lex.europa.eu/LexUriServ/Lex Uri Serv.do?uri=COM:2008:0194:FIN:EN:PDF>.

[20] In this case, the proposal of the Commission completed the legislative process which led to Directive 2009/49/EC of the European Parliament and of the Council of 15 June 2009 amending Council Directives 78/660/EEC abd 83/349/EEC as regards certain disclosure requirements for medium-sized companies and the obligation to draw on consolidated accounts, OJ L 164/42 of 26 June 2009.

[21] This latest proposal also completed the interinstitutional legislative procedures and became Directive 2009/109/EC of the European Parliament and of the Council of 16 September 2009 amending Council Directives 77/91/EEC, 78/855/EEC and 82/891/EEC, and Directive 2005/56/EC as regards reporting and documentation requirements in the case of mergers and divisions (OJ L 259/14 of 2 October 2009).

[22] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions: "Think Small First – A Small Business Act for Europe", Brussels, 25 June 2008 (COM(2008)394 final) <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0394:FIN:en:PDF>.

be helped to benefit from the Single Market etc. In December 2009 the Commission released an assessment of the implementation of the SBA[23], reminding readers that a General Block Exemption Regulation had been adopted in 2008[24] and a proposal on reduced VAT rates had entered into force on 1 June 2009[25], whereas the proposed recast of the late payments Directive and the proposal on a European Company Statute are still pending. At the same time, it was asserted that progress in the implementation of the SBA had also been reached at the level of the Member States, especially in the following areas: reduction of administrative burdens for SMEs, access to finance, access to markets and promotion of entrepreneurship.

III. Company Capital[26]

The Second Company Law Directive 77/91/EEC was recently simplified by Directive 2006/68/EC of 6 September 2006[27] (which was to be transposed into national law by 15 April 2008), in order to allow companies to adapt their capital size and ownership structure more easily to market developments. These changes were recommended among others by the Group of High Level Company Law Experts in 2002. They consist, firstly, of the possibility for companies to offer shares for contributions in kind without requiring them to obtain a special expert valuation if there is a clear point of reference for the value of this contribution. Secondly, companies are now allowed to acquire their own shares up to the limit of their distributable reserves and the authorised period for acquisition was extended. Thirdly, the rules on financial assistance granted by a company for

---

[23] <http://ec.europa.eu/enterprise/policies/sme/small-business-act/implementation/files/sba_imp_en.pdf>.

[24] Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation) (OJ L 214/3 of) 9 August 2008).

[25] Council Directive 2009/47/EC of 5 May 2009 amending Directive 2006/112/EC as regards reduced rates of value added tax (OJ L 116/18 of 9 May 2009, p. 18).

[26] Cf. *Armour*, Legal Capital: an Outdated Concept?, in: Eidenmüller/Schön (*supra* note 1), 3 et seq.; and *Fleischer*, Comment: Legal Capital: A Navigation System for Corporate Law Scholarship, ibid., 27 et seq. For a comparative perspective on legal capital: *Armour/Hertig/Kanda*, Transaction with Creditors, in: Kraakman/Armour/Davies/Enriques/Hansmann/Hertig/Hopt/Kanda/Rock, The Anatomy of Corporate Law, Oxford 2nd ed. 2009, at p. 130 et seq.

[27] Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (OJ L 264/32 of 25 September 2006).

acquisition of its own shares by a third party were made more flexible.[28] After this last modification in 2006, the Second Directive is now in a legislative process of codification, which will most probably result in a legislative proposal for a new capital maintenance directive later this year.[29]

Alongside this simplification and codification of the Second Directive, the Commission also explored an alternative to the current legal capital system, as for instance a solvency test, aimed to make distributions to shareholders more flexible. On the basis of the 2003 Action Plan on Company Law and Corporate Governance, KPMG was commissioned to conduct an external study on this issue, which was delivered in January 2008.[30] The main conclusion of the study was that the current minimum capital requirement of 25,000 Euro in the Second Directive does not represent an important obstacle to distributions to shareholders. As regards the solvency test, it should be added to the balance-sheet test rather than replaced. For the time being the Commission has not decided on any further action to be pursued on this issue.[31]

The proposed Status of the European Private Company is also of importance for the issue of legal capital under EU law. It provides for a minimum capital of 1 Euro (Art. 19(4)), thereby leaving shareholders to decide upon the level of capital they consider appropriate for each company of this type[32]. This approach aims to make rules for SMEs more flexible than those for joint-stock companies (apart from the above men-

---

[28] *Wymeersch*, Reforming the Second Company Law Directive (November 2006), University of Ghent, Financial Law Institute, Working Paper Series WP 2006-15 (available at SSRN: <http://ssrn.com/abstract=957981>; *Ferran*, Simplification of European Company Law on Financial Assistance, European Business Organization Law Review (EBOR) 6 (2005), 93 et seq.

[29] <http://register.consilium.europa.eu/pdf/en/08/st13/st13274.en08.pdf>, and the EU Commission consultation paper: Commission Services & Staff Working Document, Possible Further Changes to the Capital Requirements Directive, Brussels, February 2010 <http://ec.europa.eu/internal_market/consultations/docs/2010/crd4/consultation_paper_en.pdf>.

[30] *KPMG*, Feasibility study on an alternative to the capital maintenance regime established by the Second Company Law Directive 77/91 of 13 December 1976 and an examination of the impact on profit distribution of the EU-accounting regime, January 2008 <http://ec.europa.eu/internal_market/company/docs/capital/feasbility/study_en.pdf>.

[31] In a recent position paper related to the KPMG study, the Commission stated: "In the light of the conclusions of the external study, the view of DG Internal Market and Services is that the current capital maintenance regime under the Second Company Law Directive does not seem to cause significant operational problems for companies. Therefore no follow-up measures or changes to the Second Company law Directive are foreseen in the immediate future." (see: <http://ec.europa.eu/internal_market/company/docs/capital/feasbility/markt-position_en.pdf>).

[32] See *infra* sub VII.

tioned minimum capital requirement of 25,000 Euro under the Second Company Law Directive, it should also be remembered that the European Company must have a minimum subscribed capital of 120,000 Euro – see Art. 4(2) of Regulation Nr. 2157/2001[33]).

IV. Shareholders' Rights: Directive and Recommendations

In the field of shareholder rights, the Commission Action Plan of 2003 proposed a couple of measures aimed at strengthening the rights of shareholders in relation to General Meetings, with the longer term goal of establishing shareholder democracy in the EU. EU intervention was considered necessary and compatible with the principle of subsidiarity, given the considerable cross-border shareholding in the EU: about 30 % of the capital of European listed joint-stock companies was found to be held by non-resident shareholders (i.e. whose Member State of residence is different from the Member State of registration of the issuer).[34] In order to gather information from relevant stakeholders (institutional investors, private investors, issuers/industry, financial intermediaries, professional services providers, voting services providers, public and supervisory authorities, regulated markets) the Commission organized three public consultations (in 2004, 2005 and 2007). After the first two consultations, it decided to split the matters under discussion in two categories: the first category consisted of issues related to the exercise of certain rights of shareholders in the general meetings of listed companies (equal treatment of shareholders, information prior to the general meeting, right to put items on the agenda, right to ask questions, participation by electronic means, abolition of share blocking, proxy voting etc.).[35] The second category included less stringent matters such as stock lending, the role of intermediaries in the voting process and the language of the documents intended for the general meeting.

For the first category, the Commission proceeded with an impact assessment[36] and subsequently proposed a Directive, which was formally adop-

---

[33] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) (OJ L 294/1 of 10 November 2001).

[34] *Delsaux*, The future of EU company law. The proposal for an EU Directive for improved shareholders' rights, Finanzplatz Nr. 2 from March 2006 (available at: <www.dai.de/internet/dai/dai-2-0.nsf/dai_publikationen.htm>).

[35] *Weber-Rey*, Effects of the Better Regulation Approach on European Company Law and Corporate Governance, European Company and Financial Law Review Nr. 3/2007, p. 400.

[36] <http://ec.europa.eu/internal_market/company/docs/shareholders/comm_native_sec_2006_0181_en.pdf>.

ted on 11 July 2007 (Directive 2007/36/EC[37], to be transposed by Member States by 3 August 2009[38]). The Commission expected that this improved legal framework for shareholder rights would lead to an increase in the level of attendance at General Meetings and in the exercise of cross-border voting, which would in their turn contribute to a better corporate governance in EU listed companies.[39] For the second category of issues a third public consultation was organized, with the aim of preparing a non-binding instrument, namely a recommendation, for this purpose. Although most points raised by the Commission in the consultation document received positive responses[40], a draft recommendation was not proposed, as it was not yet considered a matter of urgency. Nevertheless it may well be that under the current financial crisis the priorities of the Commission change and such a recommendation proves to be necessary.

V. Board of Directors: Recommendations

The Commission adopted two recommendations concerning directors of listed companies: the first (Recommendation 2004/913/EC[41]) was adopted on 14 December 2004 and dealt with directors' remuneration and the second (Recommendation 2005/162/EC[42]) was adopted on 15 February 2005 covering the independence of directors.[43] In July 2007 the Commis-

---

[37] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (OJ L 184/17 of 14 July 2007).

[38] The Directive was transposed for instance in Romania by Regulation No. 6/2009 of the Romanian National Securities Commission <www.cnvmr.ro/legislatie/regulamente/ro/2009.htm) and in Germany by *Gesetz zur Umsetzung der Aktionärsrechterichtlinie* (ARUG) of 30 July 2009 (BGBl. I S. 2479).

[39] *Zetzsche*, Shareholder Passivity, Cross-Border Voting and the Shareholder Rights Directive, Journal of Corporate Law Studies, Vol. 8, No. 2, 2008, p. 289 et seq.; *Noack*, Die Aktionärsrechte-Richtlinie), Festschrift für H.P. Westermann, 2008, p. 1203 et seq..

[40] EU Commission, The Internal Market and Services Directorate-General, Synthesis of the Comments on the Third Consultation Document, Fostering an Appropriate Regime for Shareholders' Rights, Brussels September 2007, <http://ec.europa.eu/internal_market/company/docs/shareholders/consultation3_report_en.pdf>.

[41] Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies (OJ L 385/55 of 29 December 2004).

[42] Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (OJ L 52/51 of 25 February 2005).

[43] These measures were triggered, among other things, by corporate scandals concerning remuneration and supervision in boards across Member States. For an outlook on

sion published two reports on the application of the recommended standards by Member States. As regards the first recommendation, the Commission discovered that Member States had introduced high disclosure standards as regards the remuneration of directors, in some cases on a compulsory basis. Nevertheless national legislators had proved to be reluctant in giving shareholders a say in the establishment of the policy and of the criteria of remuneration.[44] In the context of the current financial crisis, the Commission decided to modify the recommendation on remuneration in order to more closely link remuneration to performance and to encourage shareholders to have a say in the remuneration policy of their company[45].

The second recommendation provided that the board should be organized in such a way as to allow a sufficient number of independent non-executive directors to play an effective role in areas where conflicts of interests usually occur, thereby increasing the control of shareholders over management. The creation of nomination, remuneration and audit committees was also recommended. In its assessment report of July 2007 the Commission found that some progress had been made in this field.[46] Nevertheless differences persist among Member States as regards the definition of independence and the inclusion in this definition of independence from the majority shareholder. Secondly, it is still possible in some Member States for the CEO to become chairman of the supervisory board, which results in a conflict of interest between the executive and the supervisory function. Finally, the rule on the presence of independent directors in all board committees has not been implemented in all Member States. This recommendation was also amended in response to the present financial crisis, in order to better define the role of the remuneration committee[47].

---

the situation in Germany for instance, see *Hopt*, European Company Law and Corporate Governance: Where does the Action Plan of the European Commission lead? in: Hopt/Wymeersch/Kanda/Baum, Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan, and the US, Oxford 2005, p. 119 et seq.

[44] EU Commission Staff Working Document, Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration, Brussels 13 July 2007, at p. 6 <http://ec.europa.eu/internal_market/company/docs/directors-remun/sec20071022_en.pdf>.

[45] See *infra* sub VIII.

[46] <http://ec.europa.eu/internal_market/company/docs/independence/sec20071022_en.pdf>.

[47] See *infra* sub VIII.

VI. Cross-Border Seat Transfer: Abandonment of the 14th Directive

In its final report of 4 November 2002, the High Level Group of Company Law Experts recommended that the Commission urgently consider adopting a proposal for a directive on the transfer of the registered office. It also suggested that certain aspects of the transfer of the de facto head office should be clarified. The Commission, in its Action Plan of 21 May 2003, undertook to adopt a proposal for a directive in the near future, considering this to be one of its main priorities.

In February 2004, under the Internal Market Commissioner Bolkestein, the Commission launched a public consultation on the structure of the proposal for a 14th Company Law Directive[48]. The public associated this proposal with the contested Directive on services in the internal market, supported by the same Commissioner. The "country of origin principle" in the Services directive and the "theory of incorporation" in the Transfer of the seat directive seemed governed by the same approach, with the aim of improving the freedom of establishment in the Internal Market. The subsequent Internal Market Commissioner, McCreevy, was more reserved on this issue and on the regulatory intervention by the European Commission. An impact assessment was considered necessary in order to establish the need for such an intervention in the market.

The corresponding impact assessment was published by the Commission in December 2007.[49] The document presented the advantages and disadvantages of possible policy actions, also taking the consequences of not taking any regulatory action in this regard into account. As for the nature of the instrument, the assessment took into consideration four main options which are also compared with the 'no action' option. Option 1 considered action by the Member States, i.e. signature of the convention on mutual recognition of companies. Option 2 envisaged a non-binding instrument, i.e. a recommendation. The last two options concerned the adoption of a binding instrument by the Union, a directive (option 3) or a regulation (option 4).

From the comparison of the different possible solutions the assessment concluded that the 'no action' option or a directive would be most appro-

---

[48] See EU Commission Press Release, Company law: Commission consults on the cross border transfer of companies' registered offices, Brussels, 26 Feburary 2004 (IP/04/270) <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/270&format=HTML&aged=1&language=EN&guiLanguage=en>.

[49] EU Commission Staff Working Document, Impact Assessment on the Directive on the cross-border transfer of registered office, Brussels 12 December 2007 SEC(2007) 1707 <http://ec.europa.eu/internal_market/company/seat-transfer/index_en.htm>.

priate for achieving the desired policy objectives. As the practical effect of the existing legislation on cross-border mobility (i.e. the Directive 2005/56/EC of 26 October 2005 on cross-border mergers[50], which was to be transposed by 16 December 2007, and the possible European Private Company Statute) was not yet known and as the issue of the transfer of the registered office might be further clarified by the Court of Justice[51], the assessment concluded that it might be more appropriate to wait until the impacts of those developments could be fully assessed. After considering the arguments presented, Commissioner McCreevy decided that there was no need for action at EU level in this field and the DG Internal Market and Services stopped working on this issue.[52]

Some Union measures, in particular the European Company Statute and the European Cooperative Society Statute[53], already grant the right of transfer of registered office, however, this possibility is available only to

[50] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies (OJ L 310/1 of 25 November 2005).

[51] The Court of Justice recently dealt with this issue in its decisions *Sevic* (C-411/03) of 13 December 2005 and *Cartesio* (C-210/06) of 16 December 2008. In *Sevic* the Court stated, that Articles 43 and 48 of the EC Treaty (currently Articles 49 and 54 of the Treaty on the Functioning of the European Union – TFUE) "preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State" (no. 31). For a presentation of the case, see for instance *Schindler*, Cross-border mergers in Europe – Company law is catching up! Commentary on the ECJ's Decision in *SEVIC Systems AG*, ECFR 1/2006, p. 109−119. In *Cartesio* the Court found, that the same Articles 43 and 48 of the EC Treaty (currently Articles 49 and 54 TFUE) "are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation" (no. 124). For a presentation of the case, see for instance *Korom/Metzinger*, Freedom of establishment for companies: the European Court of Justice confirms and refines its *Daily Mail* Decision in the Cartesio Case C-210/06, ECFR 1/2009, p. 125 et seq. In this latest case the ECJ seems to have taken a more conservative approach towards freedom of establishment, by leaving it up to the national legislator to regulate the outbound cross-border seat transfer.

[52] *Vossestein*, Transfer of the Registered Office: The European Commission's Decision Not to Submit a Proposal for a Directive, Utrecht Law Review Volume 4 (1) (2008), 35 et seq.

[53] Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) (OJ L 207/1 of 18 August 2003).

companies established as *Societas Europea* (SE)[54] or as European Co-operative Society. In practice to date, not many companies have decided to transfer their registered office on the basis of the SE Statute[55].

VII. The European Private Company

In June 2008 the European Commission submitted a proposal [COM(2008) 396] for a Regulation on the Statute of the European private company (*Societas Privata Europaea* – SPE)[56], a company form aimed at small- and medium-sized enterprises. Comparative law played a major role, as the Statute was drafted on the model of corresponding company law forms in the Member States (such as the SAS and SARL in France or the GmbH in Germany). It is part of the legislative package entitled Small Business Act for Europe, recognizing the central role of SMEs in the European economy and proposing new measures to help them conduct business across the EU. According to the Commission's assessment, these measures are necessary because 99% of companies in the EU are SMEs (i.e. companies with a maximum of 250 employees and a maximum turnover of 50 Mil. Euro). That makes up a total of about 23 Mil. SMEs compared to 41,000 large companies across EU, with the SMEs creating about 80% of the new jobs in the EU.[57]

By comparison to the current situation, where the SMEs operating across borders have to set up subsidiaries in different company forms in every Member State in which they do business, the advantage of the SPE-Statute would be that the SMEs would have a uniform company form for all Member States in which they are present, saving them time and money involved in setting up and in administering the company under different national rules. This would help improve the present situation where only

---

[54] Cf. *Oplustil/Teichmann* (eds.), The European Company: All over Europe: A State-by-State Account of the Introduction the European Company (Berlin 2004).

[55] For an empirical assessment see *Eidenmüller/Engert/Hornuf*, How Does the Market React to the Societas Europaea? European Business Organization Law Review (EBOR) 11 (2010), 35 et seq.

[56] <http://ec.europa.eu/internal_market/company/docs/epc/proposal_en.pdf>; *Hommelhoff*, The European Private Company before its Pending Legislative Birth, in: McCahery et al. (*supra* note 4), p. 321 et seq.; *Drury*, The European Private Company, ibid., p. 337 et seq.

[57] EU Commission Press Release, "Think Small First": A Small Business Act for Europe, Brussels 25 June2008 (IP/08/1003) <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1003>.

8% of SMEs engage in cross-border trade and only 5% have subsidiaries abroad.[58]

Contrary to the SE-Statute of 2001 (see Art. 2 of Council Regulation 2157/2001), the Commission's proposal for a SPE-Statute does not provide for an initial cross-border requirement (whereby at least two Member States would be involved in the setting up or in the operation of an SPE). Thereby the SPE enters in a direct contest with national company forms for SMEs, especially with the national private limited liability company. Instead of a classical top-down harmonisation of the national legislation concerning limited liability companies, the EU decides in this way to enter into a legislative competition with Member States. At the same time it faces the risk of favouring what is sometimes perceived as a race to the bottom in this field (for instance through the minimum capital requirement of 1 Euro). It may be said that this legislative proposal from the Commission is also the result of the previous case-law of the European Court of Justice on the mobility of companies across the EU. The SPE-Statute is predominantly intended to favour such mobility.[59]

According to the Statute (Art. 3), the SPE is a limited liability company, i.e. it has legal personality and its shareholders are not liable for more than the amount subscribed. It is a private company, i.e. its shares are not offered to the public and are not publicly traded. The Statute is completed by an annex containing the model articles of association of an SPE (Art. 8). The matters relating to tax law, labour law, accounting and insolvency, as well as the dissolution of the SPE or its transformation into a national company form are governed by the applicable national law, i.e. the law of the Member State in which the SPE has its registered office. In conformity with the case-law of the Court of Justice, the SPE may have its registered office and its central administration or its principal place of business in different Member States (Art. 7).

With regard to minimum capital, as already mentioned, the SPE is required to have a capital of at least 1 Euro (Art. 19). According to the Commission, recent studies show that other creditor protection factors, such as cash-flow, are more relevant than the traditional requirement of a high minimum capital.[60] This encountered opposition especially in Germany, where the minimum capital remains an important means for pro-

---

[58] See p. 1 of the *Explanatory memorandum* introducing the proposal for the SPE-Statute (cf. *supra* note 56).

[59] *Siems/Herzog/Rosenhäger*, The European Private Company (SPE): An Attractive New Legal Form of Doing Business?, Butterworths Journal of International Banking and Financial Law, 2009, pp. 247–250 (available at SSRN: <http://ssrn.com/abstract=1350465>.

[60] See p. 7–8 of the *Explanatory memorandum* introducing the proposal for the SPE-Statute (cf. *supra* note 56).

tecting creditors (the GmbH has a mandatory minimum capital of 25,000 Euro, despite recent attempts to lower it to 10,000 Euro[61]). Employee participation in the SPE is subject to the rules on employee participation applicable in the Member State in which it has its registered office (Art. 34), so that the SPE is not more or less attractive from this point of view in comparison to corresponding national company forms.

As is the case for the Societas Europaea, the proposal for the SPE-Statute was based on Art. 308 of the EC Treaty, which required Council unanimity and a consultation procedure only involving the European Parliament. That meant that the position of Member States was very strong and they were able to substantially influence the final outcome. This also explained the long period needed for the adoption of the SE-Statute. After the entry into force of the Lisbon Treaty, the SPE-Status now falls under Art. 352 TFUE, which requires the Council not only to consult the European Parliament, but also to receive its consent for this legislative measure. It is remarkable that the European Parliament reached a political agreement on the proposal of the Commission by 10 March 2009. Following a report by Klaus-Heiner Lehne (EPP-ED), some changes were nevertheless introduced, one of the most important concerning the minimum capital: this should be set at 1 Euro, provided that the articles of association require that the management body sign a solvency certificate. Where the articles of association contain no such provision, the capital of the SPE should be at least 8 000 Euro.[62] The SPE-Statute was then discussed in the Competitiveness (Internal Market, Industry and Research) Council of 3−4 December 2009, but the unanimity needed for an agreement could not be reached. The Council thus stated that further work is required on the proposal.[63]

---

[61] On the latest reform of the GmbH-Law in Germany, see for instance *Seibert*, Close Corporations – Reforming Private Company Law: European and International Perspectives, European Business Organization Law Review (EBOR) 8 (2007), 83 et seq. It should nevertheless be mentioned, that the German reform law [Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) of 23 October 2008, BGBl I Nr. 48 S. 2026] introduced a simplified form of the limited liability company (die Unternehmergesellschaft), whose minimum capital may be as low as 1 Euro (see the new § 5a GmbHG): cf. *Noack/Beurskens*, Modernising the German GmbH – Mere Window Dressing or Fundamental Redesign? European Business Organization Law Review (EBOR) 9 (2008), 97 et seq.

[62] *Kornack*, The European Private Company – Entering the Scene or Lost in Discussion? German Law Journal Vol. 10 Nr. 08/2009, p. 1323.

[63] <www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/111732.pdf> (p. 22).

VIII. Facing the Financial Crisis[64]

In response to the new challenges raised by the crisis which has been affecting financial markets across the globe since mid 2007, the European Commission convened a special committee chaired by the former Governor of the Banque de France, Jacques de Larosière. In its report of 25 February 2009, the committee identified some macroeconomic factors (like large liquidities and low interest rates), which contributed to the financial crisis, including deficient risk management, the role of credit rating agencies, corporate governance failures as well as regulatory, supervisory and crisis management failures[65]. As regards corporate governance, it was assessed that the remuneration and incentive schemes in the financial services industry had led to excessive risk-taking for short-term gains, to the detriment of the long-term profitability of investments. In this context, it was underlined that neither the boards, nor the shareholders as owners of companies were able or ready to provide the necessary supervision of management. Accordingly, it was recommended that the assessment of bonuses be from now on set in a multi-year framework, spreading bonus payments over the cycle, and that bonuses reflect actual performance, not guaranteed in advance. Furthermore, the internal risk management function in companies should be restructured in order to act more effectively, avoiding an over-reliance on external ratings.[66]

On the basis of this report, EU institutions developed both macroeconomic and microeconomic measures aimed at enhancing financial supervision in the Internal Market. The Council of Economics and Finance Ministers (Ecofin) of 9 June 2009 decided to establish a European Systemic Risk Board (ESRB) and a European System of Financial Supervisors (ESFS), charged with macro- and micro-prudential supervision respectively. These measures were approved by the European Council meeting held 18−19 June 2009, which also required the Commission to present legislative proposals concerning this new financial framework by early autumn 2009. Such proposals were to be adopted swiftly, so that the said

---

[64] For a survey of national rescue measures: *Petrovic/Tutsch*, National Rescue Measures in Response to the Current Financial Crisis, European Central Bank Legal Working Paper Series No. 8/July 2009.

[65] See also: Senior Supervisors Group, Risk Management Lessons from the Global Banking Crisis of 2008 (21 October 2009) <www.ny.frb.org/newsevents/news/banking/2009/SSG_report.pdf>; id., Observations on Risk Management Practices during the Recent Market Turbulence (6 March 2008) <www.ny.frb.org/newsevents/news/banking/2008/SSG_Risk_Mgt_doc_final.pdf>.

[66] See *De Larosière*, Report of the High Level Group on Financial Supervision in the EU, Brussels, 25 February 2009, p. 10 and p. 29−32 <http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf>.

framework would be fully functional in 2010[67]. In its meeting of 2 December 2009, the Council consequently agreed to start negotiations with the European Parliament on draft regulations aimed at establishing three new authorities for financial supervision in the EU: the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.[68] Negotiations with the Parliament are also underway on a draft regulation concerning ESRB. The adoption process of this substantial legislative package has been slowed to a certain extent by recent internal changes in the EU Institutions (with a newly elected Parliament in which more than 50 % of the MEPs serving their first term and with a new college of Commissioners)[69], as well as by the entry into force of the Treaty of Lisbon on 1 December 2009.

How, and to which extent the corporate governance and company law areas will be affected may only be extensively assessed after the inter-institutional negotiations have been completed. In any case, the Commission intends to build on the work done in the last couple of years and fill in the gaps where necessary, rather than developing a totally new regulatory strategy. The first steps were already done in April 2009 with the adoption of two Commission Recommendations on remuneration policies in the financial sector (Recommendation 2009/384/EC[70]) and on the remuneration of directors of listed companies (Recommendation 2009/385/EC[71]), which complement and amend where necessary the previous legal framework[72]. By these new measures, the Commission is trying to set certain criteria for the structure of remuneration for staff in financial institutions whose position involves an element of speculative risk taking and for directors in listed companies, in order to strengthen the link between performance and pay and to encourage long-term performance. In listed companies, shareholders are encouraged to oversee remuneration policies

---

[67] Brussels European Council of 18/19 June 2009 – Presidency Conclusions, p. 5−10 <www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/108622.pdf>.

[68] <www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111706.pdf> (p. 6−7).

[69] See also *Lannoo*, The Road Ahead after De Larosière, CEPS Policy Brief No. 195, 7 August 2009 (available at SSRN: <http://ssrn.com/abstract=1452756>.

[70] Commission Recommendation of 30 April 2009 on remuneration policies in the financial services sector (OJ L 120, 15 May 2009, p. 22−27).

[71] Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (OJ L 120, 15 May 2009, p. 28−31).

[72] See also: Committee of European Banking Supervisors (CEBS), High-level Principles for Remuneration Policies, 20 April 2009 <www.c-ebs.org/getdoc/34beb2e0-bdff-4b8e-979a-5115a482a7ba/High-level-principles-for-remuneration-policies.aspx>.

through the exercise of their rights in the general meeting, and the rules for the composition and the role of the remuneration committee have been revised in order to allow it to take a more active part in the process of setting directors' remuneration.

Another new piece of legislation is Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies[73] (CRAs), which has been in force since December 2009 and which was also adopted as a first step in the general anti-crisis policy suggested by the *De Larosière* report (see recital (51) of the Regulation). Its declared purpose is to restore investor confidence and increase their protection in European capital markets by setting EU wide standards of integrity, quality and transparency for CRAs. A similar approach may be observed in the Commission's proposal [COM(2009)207] for a new Directive of the European Parliament and of the Council on Alternative Investment Fund Managers (AIFM) of 30 April 2009.[74] The directive would cover mainly the managers of hedge funds and private equity funds (which are not covered by the new UCITS Directive 2009/65/EC[75]) and would create a regulatory and supervisory framework for the alternative fund industry in the EU. This in its turn is expected to lead to an improvement of risk management and to reliable investor information on the financial market. From a corporate governance perspective, of particular interest are the provisions of the proposed directive on the conduct of business of AIFM (Art. 9−13 regulating such issues as conflicts of interest, risk and liquidity management), on their organizational requirements (Art. 15−17 regulating internal controls and division of functions), and on their transparency obligations towards investors (see Art. 20).

To conclude, it may certainly be said that the Company Law Action Plan of 2003 was not drafted by the European Commission with an eye to the current financial crisis. Therefore, although most of the initially proposed legislative measures were subsequently completed, a substantial rethinking of the EU regulatory policy in this field was made necessary by the worsening of general economical conditions. It then became apparent, that micro- and macro-prudential measures should be closely coordinated and that certain legislative gaps should be filled in order to attain the stability of the financial sector and to offer business companies and investors

[73] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302/1 of 17 November 2009).

[74] <http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_proposal_en.pdf>.

[75] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302/32 of 17 November 2009).

a reliable legal framework at the EU level[76]. The year 2010 should witness further such developments, aimed at completing rather than at replacing the previously devised legislation.

[76] On the interface between macro- and micro-economic aspects in the global banking crisis: United Kingdom Financial Services Authority (FSA), The Turner Review: a regulatory response to the global banking crisis, March 2009, 83 et seq. <www.fsa.gov.uk/pubs/other/turner_review.pdf>; *Hüther/Jäger/Hellwig/Hartmann-Wendels*, Arbeitsweise der Bankenaufsicht vor dem Hintergrund der Finanzmarktkrise, Institut der deutschen Wirtschaft, Cologne 17 February 2009 <www.iwkoeln.de/Portals/0/pdf/dokumente_andere/2009/Gutachten%20Bankenaufsicht.pdf>.

Company Law in Bulgaria

TANIA BOUZEVA

I. Brief Survey over the Bulgarian Company Law Systems

The new Bulgarian commercial and company legislation is the result of a lengthy and complex process of adoption, incorporating the best, modern legal models from both the Roman and German systems of European law. During the process of designing modern legislation for the field of company law, both in the late 19th century, and following the changes of 1989, Bulgaria consistently aspired to the standards of the continental model, although it was not able to accomplish a full legislative codification in this area.

The transposition of European law, including company law directives, naturally raises problems with respect to its adaptation to specific Bulgarian conditions, which reflect the legal culture and practice in this country. The aspirations and efforts of the legislator to deal with these problems have proven insufficient to overcome the lack of time, experience and expertise in the field of comparative law.

1. Formation of Bulgarian Bourgeois Legislation

The first Bulgarian Commerce Act came into force in 1898 (hereinafter referred to as the Commerce Act (1898)), after the liberation of Bulgaria from Ottoman rule and the formation of the Bulgarian bourgeois state. It was based on the Hungarian Commercial Laws of 1875 and the Romanian Commerce Act of 1887, which itself followed the Italian Commerce Act of 1883. Matters involving companies and commercial transactions were taken from Hungarian law, which is based on the German system, while issues relating to bankruptcy were taken from the Romanian Commerce Act. This mixture of German and Roman law constituted and later intensified the imperfections in the Bulgarian Act.[1]

Until it was repealed, the Commerce Act (1898) provided the regulatory base for three different corporate forms; the general partnership (GP), the limited partnership (LP) and the joint-stock company (JSC). The limited liability company (LLC) based on the German legal model (Gesellschaft mit beschränkter Haftung), was not regulated by a separate law until 1924. The Limited Liability Company Act (1924) succeeded to a considerable extent in codifying the relevant subject matter related to limited liability companies, whereas the Commerce Act (1898) essentially constituted a loose compilation of legal norms that had not been sufficiently thought through, thus creating substantial difficulties for practical application. Therefore, in business disputes the court would, more often than not, apply customary rules, inherited by the Bulgarian system from the times when the Ottoman Commerce Act of 1850[2] applied.

---

[1] Thus, for example, Art. 1 of the Commerce Act (1898) stipulates as a general provision regarding sources of law that commercial lawsuits were to be governed by the relevant provisions of the Commerce Act (1898), and where none applied, by the relevant business customs and practices and if none such existed, then the relevant civil law regulations were to be adapted. To put it another way, this meant that if there was no commercial norm implemented from the German system, then a norm of custom was to be sought (the possibility of such a norm existing being itself very small, as customary cases were normally codified into law), and failing that, the relevant civil norm of the system of Roman Law was to be applied – cf. *Ganev, V.,* Zapiski po targovsko pravo [Commercial Law Papers], vol. 1, Sofia, 1933, p. 24.

[2] *Dikov, L.,* Kurs po targovsko pravo [A Course in Commercial Law], vol. 1, 3. Ed., Sofia, 1992, p. 25.

2. Corporate law in Socialist Bulgaria

The first Commerce Act (1898) and the Limited Liability Company Act remained in effect until 1951, when they were abolished. In the socialist state environment, virtually no private partnerships were allowed, in any form. Due to this fact, the only commercial entities permitted in Bulgaria during the socialist period, were 'state socialist organizations', in which the state was the sole owner. Also, during the period 1949−1983, two laws on cooperatives, both formulated in accordance with the strong socialist model implemented under Soviet legislation, were put in force; they did not, in practical terms, allow any free association beyond the framework of state cooperatives.

It was not until early 1989 (shortly before the start of democratic reforms) that the Decree No. 56 on Economic Activity[3] allowed private entities to perform business operations under the designation "*firms*". Decree 56 also provided for the creation of shareholding companies, limited and unlimited liability companies, and introduced the "citizens' firm"; although regulatory provisions were quite incomplete and, at times, mutually contradictory.

II. The Idea and Process of Codification

1. Formation of the Modern Commercial and Company Law in Bulgaria after Democratic Changes in 1989

The formation of modern Commercial and Company Law began in the early 1990s. Intended to be a codifying act[4] in the area of Commercial Law, the existing Commerce Act[5] (hereinafter referred to as the CA) was adopted in several stages: initially, a series of framework regulations with respect to commercial companies (1991); then, commercial insolvency (1994), and finally, regulations dealing with commercial transactions (1996). Specifically, for company law, various options from the world's leading models were considered for adoption and debated in 1991. Similar to the post-liberation reform, and consistent with historic tradition, the

[3] Ukaz № 56 za stopanskata deynost [Decree No 56 on Economic Activity], promulgated in Darzhaven vestnik № 4 [State Gazette No 4], 13 January 1989, repealed SG Darzhaven vestnik № 59 [State Gazette No 59], 12 July 1996.

[4] According to Bulgarian law a codifying act is a legislative act regulating a whole branch of the legal system or a separate part of it.

[5] Targovski zakon [Commerce Act], promulgated Darzhaven vestnik № 48 [State Gazette No 48], 18 June 1991, as amended and supplemented.

legal framework of Bulgarian Company Law was based on the German law model.

Hence, from adoption to the present day, the existing Commercial Act has had all the characteristics of a *sui generis* codifying act, regulating the complete subject matter of company law. Presently, there are five types of companies under the Commercial Act: General Partnership[6], Limited Partnership[7], Limited Liability Company, Joint Stock Company, and Limited Joint Stock Partnership.[8] The statutory framework of the early 1990's was relatively short and basic, and, unfortunately, where personal partnerships (General Partnership and Limited Partnership) are concerned, the lack of harmonization requirements, has meant it remained insufficient, extremely sketchy, and limited in its application.

It should be noted that in 1991, a separate Cooperatives Act was adopted, largely based on the French Law on Cooperatives, to regulate the status of cooperative companies in Bulgaria. Despite many positive features, in many respects this Act was not in compliance with general commercial legislation leading to its replacement in 1998 by a new Act, one that adopted the terminology of the Commerce Act and the standards of modern European legislation in that area.

2. Influence of EC Law (Acquis Communautaire)

The process of European harmonization was of tremendous significance with regard to the development of Bulgarian Company Law. Bulgaria signed its Agreement of Association with the European Communities in 1995. In the late 1990s and 2000, a large-scale reform was launched in an attempt to ensure the compliance of all Bulgarian legislation with the achievements of *Acquis communautaire*, including company law directives.

It should be noted that the harmonization of Bulgarian company law was a rare success in terms of quality and consistency. Several factors contributed to this: 1) interpreting sense from the concepts behind the directives' abstract provisions, rather than routinely adopting them; 2) analyzing the German experience in adopting the directives in Germany; and 3) finding the optimal compliance of the directives' provisions to the current Bulgarian regulations and taking into account specific national requirements. It is worth mentioning that, in all stages of harmonization of

---

[6] The German legal equivalent of General Partnership is the *Offene Handelsgesellschaft.*

[7] The German legal equivalent of Limited Partnership is the *Kommanditgesellschaft*.

[8] Limited Joint Stock Partnerships equals to the German *Kommanditgesellschaft auf Aktien* and the French *Société en commandite par actions*.

Bulgarian Company Law, the Max Planck Institute played a leading role with its expertise.

Thus, through a large-scale reform, in 2000, the First[9], Second[10], Eleventh[11] and Twelfth Company Law Directives[12] were implemented. A number of detailed provisions regarding the public nature of commercial companies, the capital of joint-stock and limited liability companies, as well as the generally accepted Community standards for protection of creditors and shareholders of these companies, were transposed into the current Commerce Act[13]. These were subsequently complemented by rules regulating branches of foreign merchants, as well as the rules of operation of sole-owner commercial companies. As a second stage, in 2003, the Third[14] and Sixth Directives[15] were introduced, and the Bulgarian Commercial Act was supplemented with detailed provisions for company transformations.[16] The German experience was also considered in the course of this reform, as well as the practices of five East European countries (Poland, the Czech Republic, Hungary, Slovakia, and Slovenia). Thus, Bulgaria currently uses a quite successful and modern legal framework that

---

[9] Council Directive 68/151/EEC on coordination of safeguards which, for the protection of the interests of members and others, are required of companies by Member States within the meaning of the second paragraph of Article 58 of the Treaty, in respect to the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards consistent throughout the community released 9 March 1968, OJ Nr. L 065, 14.3.1968.

[10] Council Directive 77/91/EEC on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect to the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards consistent throughout the community released on 13 December 1976, OJ Nr. L 026, 31.1.1977.

[11] Council Directive 89/666/EEC concerning disclosure requirements in respect to branches opened in a Member State by certain types of company governed by the law of another State, released on 21 December 1989, OJ Nr. L 395, 30.12.1989.

[12] Council Company Directive 89/667/EEC on single-member private limited-liability companies released on 21 December 1989, OJ Nr. L 395, 30.12.1989.

[13] For more details: Novite polozhenia v targovskoto pravo. Promenite v Targovskia zakon [New Principles of Commercial Legislation. Amendments to the Commerce Act] (O. Gerdjikov, ed.), Sofia, 2000.

[14] Council Directive 78/855/EEC based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies released on 9 October 1978, OJ Nr. L 295, 20.10.1978.

[15] Council Directive 82/891/EEC based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies released on 17 December 1982, OJ Nr. L 378, 31.12.1982.

[16] For more details: *Kalaydziev, A./Goleva, P./Markov, M./Madanska, N.*, Komentar na promenite v Targovskia zakon [Comments on the Amendments to the Commerce Act], Sofia, 2003.

allows 11 combinations of transformations (not just merger and acquisition but also spin-off and separation) between all kinds of commercial companies. The last reform of 2007 introduced the Cross-border Mergers Directive (2005/56/EC) and the additions required in order to apply the regulations related to European Company (*Societas Europaea*), European Cooperative Society, and European Economic Interest Grouping (EEIG).

With regard to the transposition of the 2003 amendment to the First Directive on electronic commercial registers (Directive 2003/58/EC of the European Parliament and of the Council of 15 July 2003 amending Council Directive 68/151/EEC, as regards disclosure requirements in respect of certain types of companies), Bulgarian company law went through a large and quite painful reform. Concurrent with the introduction of a unified electronic commercial register, the Bulgarian government initiated changes to the character and competencies required for company registration procedure. This changed the procedure from a judicial to an administrative process, and it was transferred from the courts to the newly created administration at the Ministry of Justice (the Registry Agency). The Commercial Register Act of 2006[17] had further ambitious aims including the introduction of unique national, instead of local, company names and therefore a required mandatory change of identical company names. However, the simultaneous implementation of so many changes endangered the ongoing business activities of almost 331 000 companies already in existence. These difficulties led to the enactment of the Commercial Register Act being postponed three times. Even with an envisaged three-year transition period with regard to the re-registration of the existing companies, commencing this process raised certain difficulties which resulted in some of the initial aims being abandoned. Now 15 months after the commencement of the new commercial register, various improvements are being discussed with regard to the much-criticized Commercial Register Act.

3. The Capital Market in Bulgaria: Capital Market Law

The Bulgarian Company Law model is not unitary. Beyond the closed (private) companies regulations in the Commercial Act, listed joint stock corporations are regulated by a special law, the Public Offering of Securities Act 2000 (POSA)[18].

The Bulgarian stock market was re-established following the start of democratic reforms in the 1990s. The first special law to provide rules of

[17] Zakon za targovskia registar [Commercial Register Act], promulgated Darzhaven vestnik № 34 [State Gazette No 34], 25 April 2006, effective 1 January 2008, as amended and supplemented.

[18] Promulgated Darzhaven vestnik № 114 [State Gazette No 114], 30 December 1999, effective 31 January 2000, as amended and supplemented.

stock trading and to regulate the operation of market entities was the Securities, Stock Markets and Investment Companies Act of 1995.[19] This Act established the Commission for Securities and Stock Markets as the regulatory body supervising the capital markets of Bulgaria.

In 2000, following the hyperinflation crisis[20], a global reform of public company legislation and the rules of stock trading was undertaken. The Public Offering of Securities Act was adopted, superseding the 1995 law. This new Act was predominantly based on the Anglo-Saxon model of stock trading and public offerings of securities, while incorporating some modern legislative solutions from the UK, US, Japan and South Korea.[21] The new Act enables the effective protection of investors, market stability, equal treatment of participants, transparency and irreversibility of transactions.[22] The adoption of POSA led to the renaming of the Commission on Securities and Stock Exchanges as the State Commission on Securities. In March 2003, the commission was replaced by a new regulatory body: the Financial Supervision Commission[23], which supervises the operation of several financial sectors. To date, FSC comprises the following functions: protecting investor interests, regulating the issuance of securities, supervising the operation of pension funds and insurance companies.[24]

In 2006, in view of the accession of Bulgaria to the EU and with the aim of full harmonization of Bulgarian legislation in the field of capital markets, the Public Offering of Securities Act was supplemented with the provisions of Directive 2004/39/EC on financial instruments markets.[25] The relevant legislation was completely harmonized with Directive 97/9/EC on

---

[19] Promulgated Darzhaven vestnik № 63 [State Gazette No 63], 14 July 1995.

[20] In the autumn and winter of 1996/1997, Bulgaria suffered a major crisis which caused the collapse of the banking system, leading to hyperinflation.

[21] *Bakker, M./Gross*, *A.*, Development of Non-bank Financial Institutions and Capital Markets in European Union Accession Countries. *World Bank Working Paper* No. 28, February 2004.

[22] *Dimitrov, V.*, Osnovi na pravnia rezhim na investitsionnite cenni knizha [Principles of the legal regime of the investment securities] Sofia, 2001, p. 9 et seq.

[23] Zakon za Komisiyata za finansov nadzor [Financial Supervision Commission Act], promulgated Darzhaven vestnik № 8 [State Gazette No 8], 28 January 2003, effective 1 March 2003, as amended and supplemented.

[24] *Nikolov, I.*, Publichnite druzhestva – istoriyata na edin nerazvit pazar [Public Companies: the Story of an Underdeveloped Market] *Appendix to* Pari [Money] *Daily,* No 84/2003.

[25] Council Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC released 21 April 2004, OJ L 145, 30.4.2004.

investor compensation schemes.[26] The regime for the public offering of securities was changed in compliance with the provisions of Directive 2003/71/EC, which made provisions related to the prospectus to be published when securities are offered to the public or admitted to trading.[27] The provisions of Directive 2004/109/EC on the transparency requirements for information regarding issuers whose securities are admitted for trading on a regulated stock market were also implemented into Bulgarian law.[28] The Public Offering of Securities Act also complies with the provisions of Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to collective investment in transferable securities.[29] By the adoption of the Additional Supervision of Financial Conglomerates Act[30] and the Law on Market Abuse with Financial Instruments[31], a number of European requirements were introduced to provide the necessary additional controls for related public companies operating within financial conglomerates, namely insider trading and financial market manipulations.[32]

At present, the Bulgarian Stock Exchange is a shareholding company with a registered capital of 5.9 million leva[33] and a state-owned stake of 44%. A further 39% is held by investment brokers and commercial banks, with the remaining shares divided between institutional investors (7%), natural persons (6%) and legal entities (4%). Membership of the Bulgarian

---

[26] Council Directive 97/9/EC of the European Parliament and of the Council on investor-compensation schemes released 3 March 1997, OJ L 84, 26.3.1997.

[27] Council Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC released 4 November 2003, OJ L 345, 31.12. 2003.

[28] Council Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC released 15 December 2004, OJ L 390, 31.12.2004.

[29] Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) released 20 December 1985, OJ L 375, 31.12.1985.

[30] Promulgated Darzhaven vestnik № 59 [State Gazette No 59], 21 July 2006, effective 1 January 2007, as amended and supplemented.

[31] Promulgated Darzhaven vestnik № 84 [State Gazette No 84], 17 October 2006, effective 1 January 2007, as amended and supplemented.

[32] For more details: Komentar na Zakona za publichnoto predlagane na tzenni knizha [Commentary on the Public Offering of Securities Act], Sofia, 2005; *Rankova, D.,* Razvitie na kapitalovia pazar v Bulgaria [Development of the Capital Market in Bulgaria] in: Byuletin na Komisiyata za finansov nadzor za 2004 [Bulletin of the Financial Supervision Commission for 2004].

[33] Since 1997 the Bulgarian Lev (BGN) has a fixed exchange rate to the euro 1 EUR= 1,95583 BGN.

Stock Exchange numbered 82 (investment brokers and banks) by 31 March 2009[34]. The market capitalization of BSE had reached 29 billion leva by early 2008, but as a result of the financial crisis it had dropped to under 10 billion leva by 31 March 2009[35]. Currently, there are 400 joint stock companies listed on the Bulgarian Stock Exchange in Bulgaria.

As a result of the privatization process in Bulgaria, which is almost completed, state property was transferred to private owners. At the same time, foreign capital invested in our country is being organized as 100% owned or controlled by Bulgarian companies. Private businesses in Bulgaria create about 85% of the country's GDP, which highlights another significant aspect of the company law regime.

III. Specific Company Law Issues

The dualistic model of modern Bulgarian company law was determined by its manner of codification, particularly with regard to shareholders' rights, director/shareholder relationship, and the protection of minority shareholders. The basic principles, which apply to all companies, are codified in the Commerce Act. Additional special rules concerning public companies are provided by the Public Offering of Securities Act. This differentiation has influenced the various models of reform and improvement of the organization and governance of both private and public companies. While the relevant provisions of CA have been only minimally altered with respect to private companies to implement the *Acquis Communautaire*, POSA has undergoine three major amendments (2002, 2005 and 2006) in order to accomplish the necessary harmonization with European law and for public companies to achieve better transparency and coordination in their internal operations, as well as in their interaction with third parties. Despite serious efforts, changing market conditions and numerous cases of abuse of proprietary company information have consistently necessitated the adoption of additional amendments. As a result, there are some 20 ordi-

---

[34] *Karasimeonov, P.*, Predstavyane na Balgarskata Fondova Borsa [Presentation of Bulgarian Stock Exchange] in: Byuletin na Balgarskata Fondova Borsa May 2009 [Bulgarian Stock Exchange Bulletin May 2009].

[35] Analiz na sektornata dinamika v pazarnata kapitalizatsia i targoviyata na Balgarska fondova borsa – Sofia po Natsionalnata klasifikatsia na ikonomicheskite deynosti za perioda 1.7.2008–31.3.2009 [Analysis of the Sectoral Dynamic in Market Capitalization and Trade in the Bulgarian Stock Exchange, Sofia, according to the National Classification of Economic Activities for the Period 1 July 2008 through 31 March 2009], A publication of the Bulgarian Stock Exchange, Sofia, 2009.

nances issued to supplement POSA specifying various requirements pertinent to the operation of public companies.[36]

1. Rights and Remedies for Shareholders

As a broad comment on the matter of shareholder protection under Bulgarian Company Law, it should be noted that the general company law provisions reproduce all standards in the European directives related to shareholder protection, especially minority shareholders. It should also be pointed out that the Bulgarian legislators extended shareholder protection rules not only to joint-stock companies, but also to limited liability companies, which is not generally required by the directives. This national decision was based on the idea that, in the course of creating a market economy and building their own national experience, it would make more sense to introduce the requirements for good business practices at a legislative level, rather than to rely on the natural development of this model. This is particularly true in light of the fact that limited liability companies (LLC) are significantly more prevalent as form of incorporation than the joint-stock company. Presently, in Bulgaria there are about 350 000 registered companies, of which more than 88% are LLC and approximately 4% are joint-stock companies.

As far as public companies are concerned, the special Public Offering of Securities Act encompasses specific rules for protection of investors, and minority shareholders in particular. These rules are much stricter that those related to closed private companies and include, *inter alia*, disclosure requirements, take-over bids, and rules on disposal for significant portions of company assets.

a) General information on Shareholder Rights

Generally speaking, the rights of shareholders in private and in public shareholding companies fall into two main groups: property and non-property. The first group includes the right to a dividend, which amounts to the right to receive part of the net (balance sheet) profit of the company. This part is equal to the stake in the company equity held by the shareholder (CA Art. 181 (1); POSA Art. 115c). Liquidation rights, another key property right of a shareholder are available to persons holding shares in a company at the time it enters into liquidation (CA Art. 181 (1)). Liquidation rights are further regulated by POSA (Art. 111 (4)) which provides a special rule preventing a public company from issuing privileged shares entitling their bearer to an additional liquidation quota.

---

[36] These ordinances are all available in English on the webpage of the Financial Supervision Commission: <www.fsc.bg/go.idecs?c=881>.

Bulgarian company law also guarantees the right of shareholders to participate in an increase of company equity capital to an extent equal to the amount of shares held prior to this increase. This rule is contained as a general provision in the CA (Art. 194), including the relevant terms and conditions and the restrictions required by conformity with Directive 77/91/EEC[37]. With respect to public companies, the special POSA (Art. 112 et seq) provides for significant deviations from the general rules, e.g. a prohibition on the revocation or restriction of the right of preferential registration of new shares, either by decision of the general shareholders' meeting or by decision of the governing body of the company. These rights are automatically conferred in the event of an increase in capital for a public company, and constitute dematerialized shares which may also be traded by the shareholders, entitling the bearer to register a number of shares from the new issue of the public company, (POSA Art. 112b (2))[38].

Among the non-property rights, it is worth mentioning the right to participate in corporate governance, the right to vote and the right to information. A shareholder's right to participate in corporate governance is guaranteed by the rules of convocation and conduct of the general shareholders' meeting (CA Arts. 220−223). Guaranteed voting rights enable shareholders to participate in the decision-making process represented by the general shareholders' meeting on all matters present in the agenda (CA Art. 181 (1)). The origin of voting rights in both private and public shareholding companies is conditional upon payment of the issue value of the share (CA Art. 228 (1); POSA Art. 111 (1))[39]. A shareholder's right to information is stipulated in general terms in CA Art. 224 providing that each shareholder has the right to receive information, i.e. to review all written materials related to the agenda of the general meeting, and to receive such materials free of charge upon request, as well as any and all materials from previous general shareholders' meetings of the company. Shareholders of a public company are guaranteed access to additional information, for example through the obligation on members of the governing and supervisory bodies of the company to answer questions asked by shareholders at the general meeting regarding economic and financial status and also the operation of the company; through the obligation of a public company to submit to the Financial Supervision Commission annual and quarterly reports and to publish an announcement regarding these reports in a national

---

[37] *Bouzeva, T.,* in: Novite polozhenia v targovskoto pravo [New Principles in Commercial Law] (*supra* note 13), p. 121 et seq.

[38] *Kalaydziev* (*supra* note 16), p. 414 et seq.

[39] *Gerdzikov, O.,* Komentar na Targovskia zakon. Kniga Treta. Tom 1. Chl. 158-218 [Commentary on the Commerce Act. Book Three. Vol. 1. Arts. 158-218], Sofia 1998, p. 900 et seq.

daily newspaper; and the obligation of a public company to notify the Commission of any other circumstances as defined by law, which the Commission discloses publicly, among others.

b) Protection of Minority Shareholders

Specifically for the protection of minority shareholders, Bulgarian company law stipulates a number of rights, some of which are individual, and others, collective. Individual minority rights are identical for shareholders of private and public companies alike, whereas, as far as the collective rights are concerned, usually the amount of shares required for the exercise of such rights in public companies is lower than in private companies.

First, among collective minority shareholder rights is the right to convene a general shareholders' meeting. This right is guaranteed for shareholders who have owned a minimum of 5 percent of the equity capital (CA Art. 223 (1)), for at least three months. Also, shareholders who have owned a minimum of 5 percent of the equity capital for at least three months, have the right to have new items included on the agenda of an already convened general shareholders' meeting (CA Art. 223a). The same rights are enjoyed by shareholders of public companies (POSA Art. 118); in addition, they also have the right to propose decisions in respect to matters already on the agenda of the general shareholders' meeting (POSA Art. 118 (2), item 4).

Minority shareholders also have the right of inspection, recognized for shareholders who own at least 10 percent of the equity capital of a company in ordinary shares. This amounts to the right to demand the appointment of a controller who, at the company's expense, reviews the annual financial statement of the company and reports back to them (CA Art. 251a). In a public company, a shareholder must only hold a 5 percent share of the equity capital, and the controller's inspection may extend to all account books of the company (POSA Art. 118 (2), item 2).

Another collective right of minority shareholders, stipulated by law, is the right to file claims against members of the governing bodies of a public company for damages caused to the company. This right is guaranteed to shareholders who hold at least 10 percent of the equity capital of an ordinary shareholding company (CA Art. 240a), or at least 5 percent of the equity capital of a public shareholding company (POSA Art. 118 (2), item 1)[40].

For minority shareholders in public companies who own at least 5 percent of the equity capital, POSA recognizes the right to file, on behalf of the company, a claim against a third party where the company's interests

[40] *Kalaydziev* (*supra* note 16), p. 436 et seq.

are placed in jeopardy, and the governing body has failed to do so (POSA Art. 118 (1)).

CA stipulates two general remedies for the rights of partners in a commercial company, which also apply to shareholders in ordinary or public companies: a claim to revoke a decision of the general shareholders' meeting which is in violation of the imperative provisions of the substantive law or the Statutes of the company (CA Art. 74), and a general claim for protection of the membership, in case of the violation of any membership rights of a shareholder, where no other remedial procedure is provided (CA Art. 71). Both rights are formulated as individual rights, and can be exercised by any shareholder, irrespective of the number of shares in their possession or the period of time for which these shares have been held.[41]

c) Rights of Minority Shareholders in a Tender Offer for Share Buyout or Swap

Minority shareholder rights are also protected in compulsory offerings of equity for a buyout and/or swap. Bulgaria's Public Offering of Securities Act stipulates that a shareholder who owns over 50 percent of shares, or two-thirds of the voting rights in the general meeting of a public company, whether directly, through related parties, third parties acting on its behalf, or jointly with another party under a joint management agreement, is obliged to reduce its stake to under 50 percent of shares or two-thirds of voting rights within 14 days, or to prepare a commercial offer for a buyout or swap of the equity of the other shareholders (POSA Art. 149). This kind of mandatory commercial offer is intended to provide minority shareholders with the opportunity to become familiar with the intentions of a new majority shareholder and terminate their investment where their interests do not align with those of the majority shareholder.[42]

POSA provides protection against "creeping acquisition" by not allowing a shareholder who controls more than half of the voting rights in a general meeting to acquire, whether directly or indirectly, within one year, voting shares amounting to more than 3 percent of the total equity of the company, without making a commercial offer (POSA Art. 149 (1), item 8).

Finally, a majority shareholder, who holds over 90% of voting rights, who wishes to "close" the company, i.e. transform a public into a private company, may, having made a commercial offer to the minority shareholders, buy out their equity (POSA Art. 149a). Once a commercial offer

---

[41] *Gerdzikov, O.,* Komentar na Targovskia zakon. Kniga Parva. Chl. 1-112 [Commentary on the Commerce Act. Book One. Art. 1-112], Second thoroughly amended and supplemented edition, Sofia, 2007, p. 409 et seq.

[42] *Kalaydziev, A.,* Publichnoto druzhestvo [Public company], Sofia 2002, p. 115 et seq.

is published, a shareholder who controls over 90 percent of the votes in a general meeting is obliged to buy out any shares offered by the remaining shareholders in accordance with the relevant provisions of the law. These rights are determined by the interests of minority shareholders in terminating their investment by selling their equity for a reasonable price, in view of the fact that the terms of their investment, namely, the special protection arising from the trading of shares in regulated security markets, may be subject to change following the "closing" of the company.

It should be noted that these rules are the result of systematic harmonization of Bulgarian law with European regulations. Specifically in this area, regulations have preceded the needs of investors to have their rights protected, and influence the public understanding in this matter. It is expected that further development of Bulgarian legislation will expand the scope and mechanisms for protecting the rights of minority shareholders. With the expansion of Bulgaria's regulated security markets, it is anticipated that fewer and fewer small investors will put their savings into equity of public companies and other publicly traded securities. At the same time, serious analysis of the balance between the rights of majority and minority shareholders is needed, as any imbalance in the legislative solutions would lead to opportunities for abuse, which would not be in the economic and corporate interest.

2. Director-Shareholder Relationships

The relationships between shareholders and members of the governing bodies of companies are also regulated in a dualistic manner: the Commerce Act makes general provisions for all companies, whereas special provisions for public companies are stipulated in the Public Offering of Securities Act. A noteworthy feature of Bulgarian company law is that the governance of shareholding companies allows for both a single-tier system in accordance with the British model (where the governing body is a single one, called Board of Directors) and a two-tier system in accordance with the German practice (with a management board and a supervisory board). The choice of system is determined by the general shareholders' meeting, including the possible transition from one system to the other.[43]

Importantly, Bulgarian company law contains an explicit provision to the effect that members of the governing bodies of a shareholding company should perform their duties with due diligence, acting in the best interests of the company and of all its shareholders (CA Art. 237 (2)). Due diligence, according to legal theory, is defined as the maximum level of

[43] *Goleva, P.*, Targovsko pravo. Kniga Parva [Commercial Law. Book One], 4. Ed. Sofia, 2009, p. 273 et seq.

care possible given the relevant socioeconomic circumstances and level of development of science and technology, or at least the level of care one usually applies in managing one's own affairs.[44] In the case of public companies, apart from a due diligence requirement, the legislation also imposes an obligation of loyalty to the company and a requirement to place the interests of the company over personal interests (POSA Art. 116b).

To avoid conflicts of interests, members of company governing bodies are obliged to disclose certain information to their shareholders (or, to the regulatory body for public companies) upon their election, or upon the emergence of specific relationships with third parties at a later date. This includes possession of over 25% of the equity of another shareholding company or a position as a partner in an unlimited liability private company, and participation in the governance or the governing bodies of other companies (CA Art. 237 (3); POSA Art. 114b). Specifically for public companies, following the 2002 reform, the law provides that at least one third of the board of directors and the supervisory board must be "independent" parties. Within the meaning of the law, independent parties are those who are not employees or shareholders with an over 25 percent stake in a public company or a related party, and are not in a close business relationship with the public company, and who are not members of a governing body of an entity related to the company (POSA Art. 116a (2)).

Separately for members of governing bodies, the law stipulates an obligation to notify in writing if any one of them, or a related party, is interested in a matter proposed for consideration by a governing body (CA Art. 238 (4)). In addition to disclosure, in cases like these, the member of the governing body concerned is banned from voting and participation in the decision-making process. This obligation to notify also applies in cases where a contract is concluded between the company and a member of the governing body or a party related to the latter, when business activities go beyond the scope of the normal operation of the company or significantly deviate from the market conditions (CA Art. 240b; POSA Art. 116b (1)).

For public companies, POSA stipulates stricter liability for members of their governing bodies in cases of conflicts of interests, disclosure of inside information and abuse of shareholders' rights. The law provides that members of the governing and supervisory bodies of a public company are obligated to avoid any conflicts, direct or indirect, between their own interests and the interests of the company. Where a conflict does arise, the relevant body must be fully and promptly notified in writing, and the member must refrain from participating in or exerting influence over other

---

[44] Cf. *Kalaydziev, A.*, Obligatsionno pravo. Obshta chast [Obligation Law. General Part], 2007, p. 416; *Konov*, *T.*, Osnovanie na grazhdanskata otgovornost [Grounds for Civil Responsibility], 1995, p. 142.

members of the relevant board in the decision-making process (POSA Art. 116b)[45].

To facilitate communication between the governing bodies of a public company and its shareholders, in addition to the 2002 reform, the law has introduced the position of the "director for investor relations", who must be appointed in every public shareholding company. The director for investor relations is not a member of the governing body of the company and serves to maintain effective communication between the governing body and the shareholders, as well as third parties with interests in company securities investments by communicating information about the current financial and economic condition of the company, as well as any other information to which they are entitled by law in their capacity as shareholders or investors (POSA Art. 116d)[46].

The liability of members of the company's governing bodies is addressed specifically by both CA and POSA. As a rule, board members are jointly liable for any damages caused to the company as a result of their actions (CA Art. 240). Where they are found not be at fault for a specific damage, they may be exempted from this liability. Similarly, the law also makes provisions for members of governing bodies of public companies, to only be exempted from liability by the annual general shareholders' meeting, and then, only where the annual financial statement for the preceding year and the interim financial statement for the period since the beginning of the current year until the end of the month preceding the convocation of the general meeting are countersigned by a certified auditor (POSA Art. 116c). By law, members of the managing and supervisory boards, or of the board of directors, as the case may be, must deposit a compulsory performance bond, of an amount set by the general shareholders' meeting, but no less than the gross quarterly remuneration (CA Art. 240, POSA Art. 116c). This performance bond may consist of deposited shares or bonds of the company.

Despite the existence of a significant number of provisions in both the general and the special law, the rules of conduct and relations between shareholders and members of the governing bodies seem to be taken less than seriously by many Bulgarian companies. This is especially true of closed (private) companies where the appointment of governing bodies in many cases is not determined by the economic interests of the company being run in a competent manner. Instead, the driving motivation is need

---

[45] This provision also applies to natural persons who act as representatives of legal entities, members of the governing and supervisory bodies of the company (since, under Bulgarian law, legal entities may be members of such governing or supervisory bodies of a company), as well as the procurators of a public shareholding company.

[46] *Kalaydziev* (*supra* note 16), p. 431.

for the major partner/shareholder to retain control of the business operation by appointing a "pro-forma" manager or members of managing boards. The lack of corporate culture in relations between shareholders and members of the managing and supervisory boards is the logical root cause of the largely flawed model of governance of most of the shareholding companies both private and public in Bulgaria up to the present time.

The liability of board members likewise remains a largely theoretical construct, incomprehensible to shareholders, on the one hand, and quite difficult to implement because of the unpreparedness of the judicial system, on the other. There are isolated cases in actual practice where a civil liability claim has been filed against members of corporate governing bodies for damages caused to the company.[47] Even where these claims are filed, findings of liability on the part of members of their governing bodies are even more isolated due to the near impossible burden of proof and the rather blurred line between acceptable economic risk of lawful managerial actions and felonious behaviour. Bulgarian courts are still more than conservative in their estimation of damages, despite the universally recognized rule of private law: during the past 20 years, courts have recognized damages as determined solely by the losses sustained by a company, and not by 'missed benefits', that is, the profits a company could have made.[48]

Apart from the general and somewhat abstract provisions of the law, in practical terms, the rules regarding the relationships between governing bodies and shareholders, as well as the distribution of functions within these governing bodies, have been further developed by individual companies by force of internal regulations.[49] Admittedly, in recent years, good governance practices from other countries, especially EU members, have been significantly influential in this respect. This is due to the transplantation of their own corporate culture and rules of governance onto their Bulgarian subsidiaries, in effect, transferring positive models and experience, and thereby accomplishing far more than regulation at legislative level.

---

[47] The most common cases of criminal prosecution so far have been brought against members of governing bodies of several banks in the mid-1990s, or against governing bodies of companies with state or municipal equity for criminal abuse of assets of such companies.

[48] According to Bulgarian civil law, damages fall in one of two categories: losses sustained and missed benefits – Art. 82 of the Obligations and Contracts Act; for more details see: *Kalaydziev*, Obligatsionno pravo (*supra* note 44), p. 354 et seq.

[49] Known as "Internal Rules", "Rules of procedures", "Rules on the Operation of the Board of Directors" etc.

3. Corporate Governance

Corporate Governance in Bulgaria is still a novelty, although the basic principles have been regulated by the Commerce Act since 1991. The legal framework for corporate governance also includes the Accounting Act, the Independent Financial Audit Act, and the Public Offering of Securities Act. They regulate different norms of corporate governance: protection of shareholder rights, disclosure of information, the competences and responsibilities of governing bodies, the corporate control market (mergers and acquisitions), and impose a ban on insider dealing. Bulgaria is among the countries in transition that have achieved significant progress in the regulatory framework of corporate governance.[50]

As early as 2003, individual rules of OECD Principles of Corporate Governance were introduced in the Bulgarian Commercial Act as mandatory rules for all joint stock companies. In 2007, the good governance practices for Member States of the EU and the Organization for Economic Co-operation and Development (OECD) were introduced in a national Corporate Governance Code. During the creation of the Code in 2007, the *OECD Principles of Corporate Governance* of 2004 model was used, together with the comparative law samples, adopted in Germany (the German Corporate Governance Code); France; the UK; the United States; Poland; the Czech Republic; Hungary, and Slovenia, as well as some of the rules laid down in Council Regulation (EC) 2157/2001 on the Statute for a European company. The Code focuses on the protection of shareholder rights, accountability, transparency and disclosure, the operation of corporate management, and conflicts of interest.

In the process of preparation, a balance was sought between the existing Bulgarian practice and international standards of corporate governance. The purpose of the Code is to increase the competitiveness of Bulgarian companies by introducing enhanced corporate governance in Bulgaria while making the country even more attractive to foreign investors. The application of the Code by Bulgarian public companies should enable the formation of a business environment in line with established international practices. Compliance with the principles and good practices of corporate governance is the responsibility of public companies towards their shareholders. Therefore, the Code prescribes in detail the functions of the boards of directors in single-tier management structures and the principles of partnership between the supervisory and managing boards in two-tier structures. The growing requirements for internal control and risk man-

---

[50] Bulgaria launches a Corporate Governance Code, *Global Corporate Governance Forum, February 2008* <www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/BG+LL/$FILE/GCGF-BULGARIA-Web.pdf>.

agement were ascertained during the drafting process, leading to the formulation of crucial rules that the management bodies of public companies should follow with respect to their shareholders, including specific rules for effective disclosure of information. Recommendations for honoring the interests of stakeholders[51] are also included in the context of today's requirements for socially responsible business operations.

The Corporate Governance Code conforms to the relevant statutory framework without duplicating it. It recommends ways for Bulgarian companies to apply the good practices and principles of corporate governance. The rules and norms of the Code provide standards for the governance and supervision of public companies that have proven their effectiveness over the years. An underlying foundation of this Code is the understanding of corporate governance as a balanced interaction between shareholders, company management bodies and stakeholders. Good corporate governance means loyal and responsible corporate management bodies, transparency and independence, as well as the responsibility of the company to society.

The Code is mandatory only for public companies traded on the official stock market of the Bulgarian Stock Exchange and is only recommended for other companies in the public and private sectors. Until the end of 2008, the national code had been adopted by a total of 40 public companies, 21 of which are traded on the official stock market, while the others adopted it voluntarily.

In late 2008, the Institute of Economics of the Bulgarian Academy of Sciences published the first results of a three-year survey of the challenges and current problems in the area of improvement of corporate governance, as well as an assessment of the implementation of the national Corporate Governance Code in the first year of its application.[52]

---

[51] *Keremidchiev, S.,* Towards modernization of the corporate governance in Bulgaria, Economic development and reconstruction policies South-East Europe: the influence of European integration forum, Inter-University Centre, Dubrovnik, 6–8 May 2004, <http://129.3.20.41/eps/io/papers/0501/0501004.pdf>.

[52] *Minchev, V./Angelova, M.,* Novite predizvikatelstva pred korporativnoto upravlenie v Bulgaria, proekt "Ukrepvane kapatsiteta na strukturite na grazhdanskoto obshtestvo za podobryavane na korporativnoto upravlenie i razvitie na korporativnata sotsialna otgovornost", No. 07-23-10-C/04.02.2008, finansiran po Operativna programa "Administrativen kapatsitet" [New Challenges to Corporate Governance in Bulgaria, Project No 07-23-10-C/04.02.2008: "Strengthening the Capacity of Civil Society Structures for the Improvement of Corporate Governance and Promotion of Corporate Social Responsibility", funded under OP Administrative capacity], <http://projectcsr-cg.org/docs/Analiz_MA-1.pdf>.

IV. Administration of Justice

1. Application of Legal Transplants by Judicial Authorities – Relations Between Judiciary, Private Practice, and Academia

The socialist model of law enforcement and the lack of any commercial turnover during the 50 years of socialist rule had an extremely negative impact on the professional skills of judicial authorities. The court system was largely unprepared for the civil and commercial relations emerging in the post-1989s. These circumstances have been exacerbated by inadequate professional training and qualification of staff at all levels in the judicial system following the 1989 changes, establishing a poor quality and slow paced administration of justice still prevalent today, which has become the target of criticism, including from the EC.

In addition, the implementation of a huge number of European regulations tremendously increased the complexity of Bulgarian legislation. Lawmaking in the Bulgarian Parliament was quite often reduced to a direct and literal inclusion of texts from regulations and directives into national law. This resulted in the appearance of regulations in a complex terminology that was often inconsistent with previously adopted legislation. Hence, regular legislative amendments to essential regulations now seem inevitable, creating permanent difficulties for the application of law and hindering the establishment of a uniform court practice.

Unfortunately, these statements apply to a great extent to law enforcement with respect to commercial disputes. The lack of trained and qualified judges leads to imprecise court decisions in a large number of commercial cases, especially if cases are of a more complicated legal or material nature. The overloaded court system has resulted in a great increase in the time needed to obtain a decision: it is not rare for some disputes to take five years or more to resolve. These factors explain judges' reluctance to accept new developments in Commercial Law, including European rules, which would result in significant difficulties in the process of law enforcement. As an example, the matter of the transformation of commercial companies, the details of which, although introduced in the Commerce Act more than 6 years ago, are still unfamiliar in to judges.

The socialist legal model imposed between 1944 and 1989 largely resulted in an absence of any academic research in the field of commercial law, as well as a very small number of law graduates in this country, the majority of whom, moreover, deal predominantly with family and obligation lawsuits. The democratic changes and free economic initiatives made since 1989 have created a necessity for the development of a broad reaching commercial law, which has subsequently led to an increase in the number of lawyers and legal scholars engaged in this field. With the advance-

ment of law institutes, links began to be gradually built between the justice system, private legal practice and academic circles, although this interaction is still rudimentary and sporadic in its nature, intensifying whenever certain legislation of public significance is drafted and enacted. In recent years, the National Assembly began the positive practice of appointing a permanent Advisory Council on Legislation, comprising leading practitioners and distinguished academics, who are consulted in the course of drafting legislation prior to its being put to the vote.

For the foreseeable future, the creation of a working model for the adoption of legislation that meets commercial needs and enables the proper functioning of the bodies of jurisprudence is one of the most challenging tests for the Bulgarian legal system.

2. Arbitration and Mediation

As an alternative to judicial law enforcement, Bulgaria has a long tradition in the field of arbitration justice. It dates as far back as 1896, and, in 1988, Bulgaria became one of the first countries to adopt a law, based on UNCITRAL's Model Law on International Commercial Arbitration. The International Commercial Arbitration Act[53] was initially applied only to cases where one of the parties was a foreign entity. Today, it also applies to disputes between Bulgarian citizens and commercial entities.

In addition to the Arbitration Court with the Bulgarian Chamber of Commerce and Industry existing for more than 50 years, more than 10 new arbitration courts have been established over the last few years. The speed, involving one-instance proceedings as compared with the three-instance judicial system, lower costs and comparatively highly qualified arbitrators have resulted in companies preferring arbitration, especially in commercial cases. In 1999, the range of services provided by the arbitration tribunal was expanded to include conciliatory proceedings in domestic and international disputes of a private legal nature.[54]

Although the Arbitration Court with the Bulgarian Chamber of Commerce and Industry is the oldest and most widely used arbitration tribunal in this country, there are at least seven more tribunals in Sofia alone, and two each in Varna and Plovdiv. One of the Varna-based arbitration tribunals predominantly handles cases involving international maritime law. Often in Bulgarian practice the parties to arbitration accept the competence of international arbitration institutions over their Bulgarian counterparts, which are naturally more trusted by foreign companies, the most common

---

[53] Promulgated in Darzhaven vestnik № 60 [State Gazette No 60], 5 August 1988, as amended and supplemented.

[54] *Petrov, R.*, Sad ili arbitrazh pri mezhdunarodnite targovski sporove [Court or Arbitration in International Commercial Disputes], Sofia, 2000.

of these being the Court of Arbitration of the International Chamber of Commerce in Paris and the International Arbitration Court in London.

In 2004, a special Mediation Act[55] was adopted, regulating obligations related to the process of registration and training of mediators and the adoption of detailed mediation procedures by the Ministry of Justice. Under this Act, mediation is an alternative method of resolving disputes, not just in civil litigation but also in some criminal cases, with the consent of the injured party. Since 2006, the Ministry of Justice has maintained a Consolidated Register of Mediators, listing 150 mediators to date. Public attitudes are gradually changing towards the use of this out-of-court method of resolving legal and other disputes, which is, albeit slowly, starting to grow in popularity in Bulgaria.

V. Conclusion

Bulgarian Company Law in its effective form is a result mainly of its harmonization with European Company Law. Obviously, the "Europeanization Process" has marked the development of modern European legal systems. As we say in Bulgaria, there is no need for each country to invent the wheel on its own. Harmonization has the advantage of adopting legislative institutions, tested and proven in other social systems, which are the goals for our development, without having to walk the long road ourselves. This is especially true for company law in the present globalization of the European market. When adopting a ready-made model, however, and especially using legal transplants, there is always the risk of these coming too early for the specific development level of the country, and thus remaining incomprehensible and inapplicable. This phenomenon can sometimes be observed in Bulgaria, following an intensive introduction of European rules. These are still largely unknown to the general public, and they remain merely "dormant" regulations within the national legal system. Therefore, the main and definitive consideration in the adoption of European models is that there should not be implementation of the letter of the law, but firstly, to make sense of individual institutions and rules, and then to adapt them properly according to the conditions of the national economic, social, and regulatory environment.

[55] Promulgated Darzhaven vestnik № 110 [State Gazette No 110], 17 December 2004, as amended and supplemented.

Romanian Company Law: Recent Evolution Between Autonomous Development and Legal Transplants

RADU N. CATANĂ

I. Modern Legal History and Foreign Inspiration in Romanian Company Law

1. Romania in Brief

Romania is a country located in Southeastern and Central Europe, north of the Balkan Peninsula on the Lower Danube, spanning over the Carpathian arch and bordering on the Black Sea. Almost all of the Danube Delta is located within its territory. Romania shares a border with Hungary and Serbia to the west, Ukraine and the Republic of Moldova to the northeast, and Bulgaria to the south.

The territory's recorded history includes periods of rule by Dacians, the Roman Empire, the Bulgarian empire, the Kingdom of Hungary (and later the Austro-Hungary Empire), the Ottoman Empire and the Czarist Empire. As a nation-state, the country was formed by the merging of Moldova (Moldavia) and Valahia (Wallachia) in 1859 and was recognised as independent in 1878. Later, in 1918, they were joined by Transilvania (Transylvania), Bucovina (Bukovina) and Basarabia (Bessarabia). At the end of World War II, parts of its territories (roughly the present day Republic of Moldova) were occupied by the USSR and Romania became a member of the Warsaw Pact.

With the fall of the Iron Curtain in 1989, Romania started a series of political and economic reforms. In 1991, Romania rejoined The World Bank. After a decade of post-revolution economic problems, Romania made reforms such as low flat tax rates in 2005 and joined the European Union on 1 January 2007.

While Romania's income level remains one of the lowest in the European Union, reforms have increased the speed of growth. Romania is now an upper-middle income economy. Romania has the 9th largest territory and with 21.5 million people, the 7th largest population among European Union member states.

Its capital and largest city is Bucureşti (Bucharest), the 6th largest city in the EU with 1.9 million people. In 2007, Sibiu, a city in Transylvania, was chosen as a European Capital of Culture.

Romania joined North Atlantic Treaty Organization (NATO) on 29 March 2004, and is also a member of several other multi-national organizations including the Latin Union, the Francophonie, the Organization for Security and Co-operation in Europe (OSCE) and the United Nations,

as well as being an associate member of the Community of Portuguese Language Countries (CPLP).

Finally, for the sake of completeness, it has to be mentioned that Romania joined General Agreement on Tariffs and Trade (GATT) in 1971 and one year later, in 1972, became a member of the International Monetary Fund (IMF). Romania is a founding member of World Trade Organization (WTO) – 1995. Romania is organized politically as a semi-presidential unitary state.

2. Legal Interferences

None of the three great powers mentioned above (the Austro – Hungarian Empire, the Ottoman Empire and the Czarist Empire) which dominated the Romanian territories were sufficiently interested in the capitalist development of their politically controlled areas and their legal influence did not have the necessary congruence to set them as an example for the Romanian territories. This fact may explain why a proper commercial legal system was only first implemented after Romania gained its independence[1].

Until a proper Romanian judicial system was created, different legal systems were applied on these territories. Thus, in the area under Ottoman rule, the French Commercial Code from 1807 was merely translated and remained in force from 1840 until 1864 and, with some less significant modifications, it continued to be applicable until 1887.

In 1887, the Romanian Commercial Code was adopted. It was (and still is) a copy of the most modern Commercial Code at that time – the Italian Commercial Code of 1882[2].

In Transylvania (the Western part of the country), after a period of applying the provisions of Austrian commercial law, the Hungarian Commercial Code was put into force in 1875. This codification, directly inspired by the old German Commercial Code, focussed upon merchants and companies in articles 3 to 257. From 1862, the old German Commercial Code was put into practice with certain modifications in the Northern part of Romania (Bucovina), territory laying within the dominion of the Austrian Empire. Austrian corporate legislation was also applicable in addition to the German Commercial Code, a significant state of affairs, as it enabled the existence of the limited liability company from 1906 in these

---

[1] After forming the Romanian modern State in 1854, the two historical regions of Walachia and Moldavia won their independence from Ottoman dominion in 1877. The Western and Northern part of Romania (Transylvania and Bucovina) only obtained their independence from the Austro-Hungarian Empire in 1918.

[2] Taking the French and Belgian inspiration of the Italian Code from 1882 into account, it would appear that the tradition to consider French legislative system as a model was preserved.

Romanian territories. The limited liability company was based on the Austrian law of 6 March 1906, which provided a better alternative to the German law of the time.

These evolutions reveal that due to historical circumstances, two different regulatory systems were applicable within the territory of Romania: those inspired by the French (applied in the South and in the East) and those inspired by the Germans (applied in the West and in the North). However, the cultural, linguistic and political affinities of the unified Romanian state's Capital (Bucharest) decided in favour of the French-like regulation. All the Hungarian, Austrian and German stipulations were removed in 1938, twenty years after the Great Unification of all provinces of Romania (1918). This was the moment when the 1887 Romanian Commercial Code was extended to these territories and the corporate legislation became unitary for the entire country, even though at that time, the German-based regulation could have been considered as better.

For Romania, the end of the Second World War meant the rule of a communist regime and therefore the disappearance of private property and private business associations, which rendered the 1887 Commercial Code redundant. However, the Code was not formally abolished and was not substantially modified during the communist period. Characterized by a centralized state economy, the communist regime even replaced the term 'company' with the expression 'state economic unit', enacting special laws in 1954 and 1972 specifically to govern their activities. Only Decree no. 424/1972 sought to create an appropriate legislative background for the mixed companies created with foreign partners in Romania.

The new constitutional order, established after 1989, created a serious challenge for the Commercial Code 1887: it was evidently neither adequate to provide legislative continuity, nor appropriate for the needs of a market economy, which required the modification and adaptation of corporate law provisions.

The new Law no. 31/1990 concerning corporations[3] abolished all commercial code stipulations and established a new legislative framework, suited to the new challenging economic and social realities. The main goal of this law was to allow for the founding of a larger number of companies in order to develop the private sector.

In 1990, the Romanian Legislator unsurprisingly in light of history, selected French company law to be the most suitable to the Romanian socio-

[3] Legea nr. 31 din 16 noiembrie 1990, Legea societăților comerciale [Law no. 31 from 16 November 1990, Company Law] was first published in the Romanian Official Journal no. 126–127 of 17 November 1990, and most recently re-released in the Romanian Official Journal no. 1066 of 17 November 2004. Its last amendment was dated April 2009.

judicial system. Law no. 31/1990 was therefore drawn up following the pattern of French Company Law from 24 July 1966, and the relevant sections of the French Civil Code, both of which had been updated prior to 1990.

The Romanian Commercial Code has for the most part become obsolete, although it has never been repealed and it is still in force. However, its very essence and existence are today being put into question with the adoption of *the new Romanian Civil Code*, which the Government presented to the Romanian Parliament on 22 June 2009. The Civil Code from 2009[4] represents a modern codification seeking a place within the European effort to harmonize private law. Foreign influences on the Civil Code can be traced back to the French, Italian, Swiss, German, Québec and Brazilian Civil Codes[5]. One of the key orientations of the New Romanian Civil Code is the unification of civil and commercial obligation regimes (traditionally separated according to the French model). The new Civil Code does not repeal the Commercial Code, but the latter effectively remains redundant, as commercial obligations and contracts are from now on regulated in the Civil Code. The new Civil Code also does not repeal Law no. 31/1990 for commercial corporations, meaning that insolvency procedures will continue to be ruled by Law no. 85/2006 even after the new Civil Code becomes effective[6].

In summary, other European legislations have had a fundamentally important impact on the Romanian commercial legal system. With regards to the specific influence of particular sources of law, Romanian legislation historically has been most heavily influenced by French law, with some recent 'embellishment' from German and US corporate law[7].

---

[4] The new Romanian Civil Code is to be set into force at a date which will be subsequently established by the Parliament's Law (all expectations are for 2010).

[5] Even though some of these models may seem "exotic", these influences are revealed by the Romanian Government in the *Rationale* of the Law Project concerning the Civil Code, presented to the Roman Parliament on 22 June 2009, available in Romanian, as of 29 June 2009, from the Ministry of Justice web site: <www.just.ro/Sections/PrimaPagina_MeniuDreapta/Codulcivilsipenal230609/tabid/1091/Default.aspx>.

[6] Legea nr. 85 din 5 aprilie 2006 privind procedura insolvenței [Law no. 85 from 5 April 2006 on insolvency procedure], published in the Romanian Official Journal no. 359 of 21 April 2006.

[7] As will be discussed in this article, the evolution of the Romanian Corporate Law is so far from being an "autonomous development", it could even be said that the Romanian business legislative system completely lacks originality.

II. Reorganization of Former State Economic Units and the Privatization Process

1. First Steps in the Privatization Process (1990−1994)

Immediately after the collapse of Communist regime, the necessary transformation of the former state owned economic units required to enable ownership by economic agents was realized by Law no. 15/1990[8]. According to this law, some of the state owned enterprises became private commercial companies (*companies*) while others were reorganized into public interest corporations (*régies autonomes*). This act reflected a tradition in Romania inspired by the French system, namely, the division of enterprises between those offering strategic public services and those conducting other economic activities (productive, trading or services). The State became the sole holder in both forms of business.

Public interest corporations (*régies autonomes*) did have their own legal personality and a particular patrimony, but their registered capital was not divided into shares. Their operation relied on a hierarchical subordination to the central or local authorities which founded them and supervised their activity. Their regulation was closer to public law, rather than to private company law.

As many *régies autonomes* failed in reaching the objectives for which they had been founded (circumstances of economic efficiency), at the request and with the support of international actors such as the International Monetary Fund, The World Bank and the European Union, the Government decided to reorganize this company form into state-owned joint-stock companies in 1997[9], with a view to eventual privatization[10]. The new

---

[8] Legea nr. 15 din 15 din 7 august 1990 privind reorganizarea unităţilor economice de stat ca regii autonome şi societăţi comerciale [Law no. 15 of 7 August 1990 on the reorganization of the state economic enterprises as autonomous régies and commercial companies], published in the Romanian Official Journal no. 98 of 8 August 1990.

[9] Except for some state monopolies like the Romanian Lottery, the Official Journal of Romania, the National Imprint etc. that have been excluded from reorganization because of strategic or national sovereignty reasons.

[10] Two of the most relevant examples of privatized public interest corporations are:

(i) The national telecommunications company, *Romtelecom* started its privatization in December 1998 when *Hellenic Telecommunications Organization OTE* bought 35% of the Romtelecom's shares. At the same time, the Greek company gained the usufruct right for another 16% of the shares, by paying 675 mil. USD. In January 2003 OTE became the (major) stockholder, owning 54.01% of the stock, for a price of 273 mil. USD.

(ii) In 2004, 33.34% of the largest petroleum company *Petrom*'s shares were bought by the *Austrian company OMV* for 669 mill. Euro, while other 830 mill. Euro were used for the increase of the registered share capital of Petrom SA, so that OMV owns 51% of the Romanian company's capital.

"national company" – a state owned corporation focused on national or local interest activities – had been created and continues to exist in the areas of electricity, gas, railway and air transport, mining extraction etc.

The commercial companies were created to accelerate the privatization process and attract local and foreign investors, capable of streamlining companies for efficient operation and therefore providing secure jobs. These companies were governed from the beginning of their existence by Company Law no. 31/1990, which has been modified over 20 times within the last 19 years.

The privatization process started, in accordance with Law no. 58/1991, when 30% of the shares that structured the capital of all trading companies created in 1990 were distributed between the five regional entities called Fondul Proprietății Private – FPP (Private Ownership Funds). Meanwhile, the other 70% of shares were attributed to the Fondul Proprietății de Stat – FPS (State Ownership Fund).

Some of the companies had already been privatized by 1995, by selling State shares to the company management and employee associations especially created for this purpose (management-employee buyout – MEBO[11]), who had been granted bank credit facilities for this purpose. The real beneficiary of this process was usually the companies' directors who managed to obtain more shares than their employees, as most of the associations finally decided to sell the package to some appropriate local or foreign investors. The employees had neither the management skills, nor the necessary financial resources to deal with the market economy.

2. Accelerating the Privatization Process (1995−2004)

The most important privatization step was the mass privatization of 1995, when all shares obtained by the five Private Ownership Funds were distributed for free to all Romanian citizens, via coupons or certificates. All former state commercial companies were partially privatized, to a level of 30% of their registered share capital. The shares distributed through this process started to be listed on the freshly and especially regulated (in 1994) capital market (Bursa de Valori Bucureşti – Bucharest Stock Exchange – and Romanian Association of Securities Dealers Assisted Quotation – RASDAQ).

70% of the equity capital of these companies was still administered by the State Ownership Fund and was to be sold to private investors starting in 1997 (based on the Government Emergency Ordinance no. 88/1997 concerning the privatization of trading companies). Since then, privatization

[11] MEBO is the acronym for "Management Employee Buy-Out" as method of privatization.

has accelerated with the adoption of about fifteen new laws and ordinances that modified the legal parameters established in 1997. In 2000, the Governmental Emergency Ordinance (GEO) no. 296/2000 created Autoritatea pentru Privatizare şi Administrarea Participaţiilor Statului – APAPS[12] ("Authority for the Privatization and Administration of State Participations"), with the goal of applying the governmental privatisation strategy. During the spring of 2004, a new institution was created in order to achieve privatization in Romania: Autoritatea pentru Valorificarea Activelor Statului – AVAS ("Authority for the State Assets Recovery").

This legal framwork was intended to implement privatization according to such principles as: securing transparency for the privatization process; sale at market price according to demand/supply; implementing restructuring programs prior to privatization; reconsidering the debts of some companies in order to increase the attractiveness of the privatization offer; and implementing a special administration process during the privatization period.

Specific to this privatization step was the subsequent creation of an internal market for corporate control and takeovers. Until 2004, the reputation of the Romanian business environment suffered from legal instability and the country's international low rating. Thus, foreign institutional and strategic investors were put on hold, while the opportunity was offered to local investors to participate in most instances of privatization. These local investors subsequently resold their controlling positions in privatized companies (often after literally a leveraged buy-out strategy) to strategic foreign investors, after the accession of the country to the EU was certain and the *acquis communautaire* processes implemented.

It could easily be concluded with regard to the evolution of the privatization process that the promising normative and conceptual framework started in 1991 was followed by an inconsistent and weak real privatization trend. Indeed, very few State-owned enterprises had been privatized by 1995, predominantly small-and-medium companies using the MEBO approach. In the meantime, the privatization program was affected by a lack of transparency, as official statistics did not contain privatization information[13]. A significant jump in the corporate ownership was brought by accelerated privatization law in 1995, which led to the transparent mass

[12] Ordonanţa de urgenţă nr. 296 din 30 decembrie 2000 privind înfiinţarea Autorităţii pentru Privatizare şi Administrarea Participaţiilor Statului [Governmental Emergency Ordinance no. 296 from 30 December 2000], published in the Romanian Official Journal no. 707 of 30 December 2000.

[13] M. Drăghici, *Privatizare şi postprivatizare în economia românească*, ["Privatization and Postprivatization in Romanian Economy"] <http://universulenergiei.europartes.eu/articole/economie/privatizare.pdf>.

privatization of 30% of the most important state owned enterprises. Keeping the level of privatisation down to 30% ensured that the disparate ownership which ensued did not interfere with efficient government policies.

The rest of the state's ownership in the economy (up to 70% of the share capital) was sold to private investors between 1999 and 2004, with the most significant companies constituting 61,50% of the entire capital privatized after 1991[14]. During this period, Romania benefited from international financial support (especially from the International Monetary Fund and the World Bank) to make many companies burdened by the accumulation of enormous fiscal and social debt more attractive. By the end of 2004, more than 97% of all state-owned companies were privatized, in the commercial, industrial and agricultural fields.

III. Ownership Structure of Romanian Companies

The effects of these privatization methods and the inconveniences of the first Capital Market Law[15] (applied from 1995) led to a concentrated ownership and control of the 440 currently listed Romanian joint-stock companies. Of these companies, only about 20% have more then 2000 shareholders (minimum threshold required for a reasonably liquid market) and about 78% of the companies have a large majority shareholder (individually or acting in concert). The five former Private Ownership Funds created during the mass privatization and reorganized in 2004 as Societate de Investiții Financiare – SIF (Financial Investment Company) and some local private banks (such as *Transilvania Bank*) are among the few who have a dispersed ownership without controlling shareholders.

If one also takes into account the fact that Romanian companies show a preference financing from commercial and banking capital, this ownership structure contributes to the lack of interest in the capital market, generates

---

[14] According to the Final Report of AVAS for the period 1991 – April 2004 and to the preliminary Report for 2004, both on the official web site of the Romanian privatization authority: <www.apaps.ro>.

[15] Legea nr. 52 din 7 iulie 1994, Legea privind valorile mobiliare şi bursele de valori [Law no. 52/1994 concerning the securities and the stock exchanges], published in the Romanian Official Journal no. 210 of 11 August 1994, was drafted and became effective with the financial support of the Canadian Government, the British Know How Fund and the USAID and with the supporting expertise of British, American and Canadian specialists (see Consolidation of Securities Market in Romania, in Romanian, available at: <www.ssif.ro/col_docs/doc_5_ro.doc>. The initial structure of the Romanian capital market implicitly followed these models. However, it may have been too soon and less appropriate to implement such modern legal frameworks to an unborn capital market.

illiquidity and a high level of possible market abuse by the market makers. One should add that most of the foreign investment funds withdrew from the market in 2008.

IV. Company Law Codification

The structure of Company Law legislation follows the separation between regular companies and listed corporations.

Law no. 31/1990 represents the legal framework for all forms of commercial companies. Following the French and German basic models, there are five types of companies: general partnership (*société en nom collectif, offene Handelsgesellschaft)*, simple limited partnership (*société en commandite*, *Kommanditgesellschaft)*, partnership limited by shares, joint-stock company (*société anonyme*, *Aktiengesellschaft*) and the limited liability company (*société à responsabilité limitée, Gesellschaft mit beschränkter Haftung*). All company forms are legal entities and taxed independently. The norms of Law no. 31/1990 apply to all close joint-stock companies, as well as providing "a common law" for listed joint-stock companies. Law no. 31/1990 has been modified 24 times in the last 18 years, three of which featured major reforms (1997, 2003, 2006).

Law no. 297/2004 concerning the capital market[16] provides the primary special regulations for listed joint-stock companies (Romanian: *societate pe acțiuni* – SA), as well as for all forms of companies providing financial services (such as financial intermediaries and investment funds). Secondary norms are issued by Comisia Națională a Valorilor Mobiliare – CNVM (National Securities Exchange Commission), the sector's supervisory and regulatory authority which has proven rather weak and inconsistent in enforcing administrative sanctions on market players, despite displaying an enthusiasm for issuing regulations (CNVM has issued over 120 regulations since the enactment of Law no. 297/2004).

The company law system also includes *Law no. 85/2006 concerning insolvency procedures and Law no. 26/1990* (modified 11 times) *concerning the Trade Registry*[17].

The nature of Company Law rules reflects the rather weak private ordering available in the law. The constitution, operation, modification and

---

[16] Legea nr. 297 din 28 iunie 2004 privind piața de capital [Law no. 297 from 28 June 2008, Capital Market Law], published in the Romanian Official Journal no. 571 of 29 June 2004.

[17] Legea nr. 26 din 5 noiembrie 1990 privind registrul comerțului [Law no. 26 from 5 November 1990 concerning the Trade Registry], published in the Romanian Official Journal no. 121 of 7 November 1990.

termination of all forms of companies reveal a skeleton of imperative norms. However, significant permissive provisions and contractual freedoms are granted to partners in closed companies (general partnerships and limited partnerships), although these companies are not used in practice[18]. The limited liability company benefits from permissive provisions, except for mandatory constraints concerning the right to sell the shares to third parties, (upon the approval of associates representing 75% of the capital). Any modification of the limited liability company statutes requires a unanimity of votes, where the associates failed to provide otherwise in the articles of association.

Some supplementary norms are also provided for joint-stock companies (both private and listed), especially after the reforms of 2003 and 2006:

- The quorums and majorities required for adopting resolutions are very low and subject to modification by a decision of general shareholders' meeting;[19]
- New voting modalities may be introduced (telecommunication; electronic);
- Option to reduce legal thresholds (%) required for minority shareholders to exercise selected information, surveillance and control rights against the management[20].

V. The Role of Comparative Law in the Post-1990 Codification Process

During the post-1990 codification process, different models were used as inspiration for the new Romanian legislation. Taking into consideration the fact that many significant reforms in business law were generated or occasioned by agreements concluded by the Romanian Government with inter-

---

[18] According to the National Trade Registry as of 31 January 2009, general and limited liability partnerships represents only 2.5% of the total number of companies, while 95% of all companies are limited liability companies. Statistics are available at: <www.onrc.ro/statistici/sr_2009_01.pdf>.

[19] With a view to ensuring the validity of the proceedings of both ordinary and extraordinary general assembly, the law requires shareholder attendance of at least *one fourth* of the total number of rights to vote. The decisions of the ordinary general assembly shall be taken by *the majority* of the votes cast. Exceptional decisions (such as share capital increases, merger, dissolution and winding-up of a joint-stock company) can be validly adopted with a special majority of two thirds of the votes cast. *The constitutive act may provide higher requirements of quorum and majority.*

[20] As it will be more detailed showed below, the general legal threshold for exercising specific minority shareholders rights is 5% of the share capital.

national institutions (such as The International Monetary Fund, the World Bank, EU institutions, USAID etc.), comparative law provided the basic platform for foreign consultants hired under international grants, to guide the drafting of new national norms. For instance, German specialists inspired the 2006 Company Law's modification, explaining the numerous German influences found in the current version.

The French model however, does not lose its primacy. The most relevant example is the New Civil Code, adopted by the Romanian Government for application from 2011. The French Civil Code (as amended) provided the primary source of inspiration for the lawyers who worked on this fundamental law, although the civil codes of Québec, Switzerland, Germany, Italy and Brazil were also taken into consideration, to different degrees[21].

The importance of comparative law is evidenced through its use as a research method in academic debate and by practitioners to support their arguments in courts, sometimes as a supplementary means of formulating interpretations of legal or contractual Romanian norms.

Comparative law may be also seen as a legislative technique used, leading to direct and sometimes surprising legal transplants. This approach leads to the assumption of legal concepts or institutions into the Romanian legal system from legal systems belonging to established societies and prosperous economies. Traditionally, for obvious cultural reasons, the French influence usually prevailed.

VI. Impact of Free-Market Thinking After 1990. The Testament of Communist Mentalities

In late December 1989 the communist regime collapsed. After this moment, like other countries in Central and Eastern Europe, Romania entered a "transitional" period from a totalitarian regime to a political organization based on the values and institutions of liberal democracy, from the economy of a centralized state to a market economy.

Immediately after the fall of the Communists, the provisional government in power until the first free elections (held in May 1990), declared the long-term objectives and eventual course of an extensive reform program – the introduction of a market mechanism and private economic

[21] See "Expunerea de motive" [Rationale] of the New Civil Code's project on Romanian Ministry of Justice web page: <www.just.ro/Portals/0/Coduri/Civil/Expunere%20de%20motive%20Cod%20civil%20-%20adoptat%20in%20sedinta%20Guvernului%20din%2011%20martie%202009.doc>.

activity – while at the same time taking steps to improve the standards of living of an exhausted population.

In spite of the great determination which characterized the new democratic regime, it has been confronted with challenges rooted in the communist period. The lack of democratic values[22] resulted in a high level of risk aversion and discouraged free economic initiatives, major inconveniences compounded by the weak governance of the 1990's.

The legal framework was characterized by an enormous legislative void in some areas with excessive regulation in others. Exacerbating this was the tendency of local entrepreneurial initiatives to avoid or even violate existing legal norms, while the foreign capital was discouraged from entering the Romanian market by the instability of the legal framework[23].

For more than 50 years, the real estate legal regime in Romania was one of collective property. After 1989, private property was restored with some difficulty due to the inconsistent legal, administrative and judicial procedures[24].

Another difficulty confronting Romania was a negative perception based on social inequalities. The majority of successful businesses are still negatively perceived and private fortunes acquired after 1990 are generally viewed with a level of suspicion. The highest expression of risk aversion was the strong belief that social and economic growth should be fostered by state intervention.

The privatisation process continued for approximately ten years after the new Romanian free market society was born before being wound up. The privatization methods had led to a very concentrated level of ownership and control, offering few reasons to encourage small business initiatives or minority shareholder activism. In addition, inter-enterprise debts began to accumulate, threatening a return to barter[25], while the State continued to appropriate funds through privatization and tax policies. The latter lead us to another characteristic of the economic environment, which was the lack of liquidity in the general economy, especially in banks and the capital market.

---

[22] The "democratic values" are the specific values of capitalist system, such as democracy, private property, freedom or market economy.

[23] The most uncomfortable legal issue is represented by the numerous modifications of some of the most important regulations. For example, Law no. 31/1990 – Romanian Company Law – was modified 24 times between 1990 to 2009.

[24] Legea nr. 18 din 19 februarie 1991, Legea fondului funciar [Law no. 18 from 19 February 19, 1991, Law on the Land Resources] was modified from 1991 to 2009 for no more than 20 times.

[25] Liliana Pop, "Time and crisis: framing success and failure in Romania's post-communist transformations", in *Review of International Studies*, 33:395–413 Cambridge University Press, 2007.

An overwhelming level of suspicion towards the new political elite has come to light, including a lack of trust in the systems of justice.[26] The Romanian population is dissatisfied with the functioning of the market economy and State of Law. The dominant mood of the population is one of dissatisfaction and negativity towards the way things work in Romania. Negative feedback on the direction the country is headed is more widespread among those who perceive a worsening of their personal situation, a situation primarily associated with the failed functioning of democracy and the market economy[27].

Nevertheless, Romanians have a great level of trust in the Enlarged European Union (EU27)[28]. The prospect of accession to the *Schengen* Countries (intended for March 2011) and the adoption of the Euro (probably in 2014) may be identified as causes for a high level of trust, which also provides buoyancy to the collective thinking of the Romanian population.

VII. Influence of Acquis Communautaire

1. Romania's Way to the European Union

On 1 February 1993, Romania concluded The Association Agreement with the European Communities and Member States[29], creating an area of free trade and acknowledging Romania's intent to accede to the European

---

[26] According to the last Euro-Barometer (*Standard Euro-Barometer 70 – October/ November 2008*, published in January 2009, page 30), only 25% of the Romanians trust the justice system, 19% trust the national Parliament and only 14% trust political parties. These figures represent only half of the results registered in west European countries. National research institutes obtained the same results. See, for example, The National Institute for Opinion Surveys and Marketing (INSOMAR) Barometer, based on research conducted between 30 April and 5 May 2009. Available on: <http://ec.europa.eu/public_ opinion/archives/eb/eb70/eb70_ro_nat.pdf>; available on: <www.insomar.ro/documente/ barometre/2009_04_interpretare_rezultate_barometru_social_politic_INSOMAR.pdf>.

[27] Horia Rusu Fundation/The Gallup Organization, *Capitalism in the Romanian Mentalities*, poll (national) 2005.

[28] According to the above-mentioned Euro-Barometer, 63% of the Romanians trust EU27.

[29] The Association Agreement was ratified by the Romanian Parliament by Legea nr. 20 din 6 aprilie 1993 pentru ratificarea Acordului european instituind o asociere între România, pe de o parte, şi Comunităţile Europene şi statele membre ale acestora, pe de altă parte, semnat la Bruxelles la 1 februarie 1993 [Law no. 20/1993 regarding the ratification of the European Accord which establishes an association between Romania, on one side, and the European Communities and their Member States, on the other side, signed at Bruxelles at 1 February 1993], was published in the Romanian Official Journal no. 73 of 12 April 1993. The Agreement was enforced from 1 February 1995.

Communities. This document represents the legal framework of the relationship between Romania and the European Union.

At Copenhagen, on 21–22 June 1993, the Member States agreed that the Central and Eastern European countries (including Romania) would be eligible to become Member States, once they had met the economic and political requirements.

Based on the Association Agreement, two years later, on 22 June 1995, Romania submitted a request of assent in order to accede to the European Union.

Two significant milestones occurred, one in March 1998 with the European Union beginning its expansion process and, December 1999 in Helsinki, when the European Council decided to start accession negotiations with Romania.

The *acquis communautaire* is structured into 31 "chapters of negotiation". Chapter 5 is dedicated to *Company Law*[30]. This chapter was opened under Sweden's EU Presidency (first semester of 2001, March 2001) and was provisionally closed under the Belgian EU Presidency (second semester of 2001, November 2001). It was not renegotiated or re-opened until the Treaty of Accession was signed. The main issues covered in this chapter were:

- Section 1 – Company Law
- Section 2 – Company Accounting (Financial Statements)
- Section 3 – Protection of Intellectual Property
- Section 4 – Protection of Industrial Property
- Section 5 – Civil Law (*Brussels and Lugano Conventions* on jurisdiction and the enforcement of judgments on civil and commercial matters and the *Rome Convention* on the law applicable to contractual obligations).

The negotiation process ended in December 2004, and the European Council (Brussels) confirmed the accession agenda immediately. Romania was recommended to continue the reforms and to implement the tasks undertaken in relation to the *acquis communautaire*.

On 13 April 2005 the European Parliament released its mandatory advice by which European Union will accept Romania as a future Member

[30] The acquis in this chapter covers very different legislative fields: *company law in the strict sense* (e.g. directives on the public disclosure of the identity of those empowered to represent a company, its financial situation, raising, maintenance and alteration of capital in case of public liability companies, accounting law, protection of intellectual and industrial property rights), as well as the *Regulation replacing the Brussels Convention on jurisdiction and the enforcement of judgments on civil and commercial matters* and the *Rome Convention on the law applicable to contractual obligations*.

State and the Treaty of Accession[31] was concluded between the European Union Member States and Bulgaria and Romania on 25 April 2005. The agreement entered into force on 1 January 2007. Until this date, Romania had the status of an Observer Member State (it participated in the legislative process of all European institutions, but did not have the right to vote).

The Treaty of Accession not only arranged the accession of Bulgaria and Romania to the EU, but also amended earlier Treaties of the European Union, becoming an integral part of the constitutional basis of the European Union.

2. Translating, Transposing and Implementing the Acquis Communautaire regarding the Company Law

As regards the application and transposition of the *acquis communautaire*, there are two different periods of time to be considered:

- Until becoming a Member State, based on the Association Agreement, Romania was legally bound to harmonize its newly issued legislation with the *acquis communautaire;*
- After becoming a Member State, based on the Treaty Establishing the European Communities (Treaty on European Union), Romania was legally bound to apply the directly applicable and mandatory EU enact-

[31] The Treaty of Accession was ratified by the Romanian Parliament in a extraordinary Parliament's meeting and was adopted unanimously. The Treaty of Accession was ratified by Legea nr. 157 din 24 mai 2005 pentru ratificarea Tratatului dintre Regatul Belgiei, Republica Cehă, Regatul Danemarcei, Republica Federală Germania, Republica Estonia, Republica Elenă, Regatul Spaniei, Republica Franceză, Irlanda, Republica Italiană, Republica Cipru, Republica Letonia, Republica Lituania, Marele Ducat al Luxemburgului, Republica Ungară, Republica Malta, Regatul Țărilor de Jos, Republica Austria, Republica Polonă, Republica Portugheză, Republica Slovenia, Republica Slovacă, Republica Finlanda, Regatul Suediei, Regatul Unit al Marii Britanii şi Irlandei de Nord (state membre ale Uniunii Europene) şi Republica Bulgaria şi România privind aderarea Republicii Bulgaria şi a României la Uniunea Europeană, semnat de România la Luxemburg la 25 aprilie 2005 [Law no. 157 from 24 May 2005 concerning the ratification of the Treaty between the Kingdom of Belgium, the Czech Republic, the Kingdom of Denmark, the Federal Republic of Germany, the Republic of Estonia, the Hellenic Republic, the Kingdom of Spain, the French Republic, Ireland, the Italian Republic, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Grand Duchy of Luxembourg, the Republic of Hungary, the Republic of Malta, the Kingdom of the Netherlands, the Republic of Austria, the Republic of Poland, the Portuguese Republic, the Republic of Slovenia, the Slovak Republic, the Republic of Finland, the Kingdom of Sweden, the United Kingdom of Great Britain and Northern Ireland (Member States of the European Union) and the Republic of Bulgaria and Romania, concerning the accession of the Republic of Bulgaria and Romania to the European Union, signed by Romania at Luxemburg, at 25 April 2005], published in the Romanian Official Journal no. 465 of 1 June 2005.

ments (such as Regulations) and to transpose EU Directives into national legislation (according to article 249 of the Treaty).

a) Romanian Company Law and EU Company Law before Romania's Accession

For the first period, a specific internal mechanism was developed – Programul Național de Aderare a României la Uniunea Europeană (National Program for Romania's Accession to the European Union)[32] – including a special component meant to ensure consistency between Romanian legislation and that of the European Union. This Program was intended to apply from 2002 onwards, and contained clear responsibilities and deadlines for each of the institutions involved. However, this mechanism was replaced with a new one in 2003, called Programul Național al Priorităților Legislative pentru Integrarea României în Uniunea Europeană (National Legislative Priorities Program for Integration in European Union), which appeared to adopt a more internal programmatic approach. However, the purpose of each of these programs was the same: to transpose the *acquis communautaire* into Romanian legislation.

On 22 July 2000, the Romanian Government passed its *Position Document on Chapter 5 – Company Law*. It was subsequently modified on 24 November 2000, pledging that "Romania accepts the whole *acquis communautaire* as effective on 31 December 1999, does not solicit a transition period or a waiver and that it will be able to apply the entire *acquis communautaire* at the date of its accession to the EU". By the same document, Romania "undertook to implement the total harmonization of the internal legislation which concerns company law by 31 December 2004."[33]

On that date, Romania acknowledged that six Directives and one Regulation were to be adopted into the national company law (*stricto sensu*). Romanian Company Law was and after numerous modifications, still is,

---

[32] Programul Național de Aderare a României la Uniunea Europeană (National Program for Romania's Accession to the European Union was established by Hotărârea Guvernului nr. 119 din 9 martie 1998 privind elaborarea Programului național de aderare a României la Uniunea Europeană [Governmental Decision no. 119 from 9 March 1998 regarding the elaboration of the National Program for Romania's Accession to the European Union], published in the Romanian Official Journal no. 112 from 12 March 1998. It was repealed and substituted by Hotărârea Guvernului nr. 114 din 26 februarie 1999 privind actualizarea Programului național de aderare a României la Uniunea Europeană [Governmental Decision no. 114 from 26 February 1999 regarding the update of the National Program for Romania's Accession to the European Union], published in the Romanian Official Journal no. 98 of 8 March 1999.

[33] The document was elaborated by the General Secretariat of the Romanian Government. A Romanian version of it is available at: <www.sgg.ro/docs/File/integrare_eu/NegociereRO.pdf>.

contained – in Law no. 31/1990, which comprises the relevant provisions on company law and also the common rules applicable to all Romanian companies. The general framework is completed with Law no. 26/1990 concerning the Trade Registry. From the date the Position Document was released, the Romanian Government had anticipated that the provisions of Law no. 31/1990 and Law no. 26/1990 were almost entirely harmonized with the relevant EU legislation (some of the EU Directives provisions were envisaged since 1990, when the first version of the Romanian Company Law was adopted). However, Romania was aware that further modifications were needed, in order to assure Romanian legislation's full compatibility with the EU legislation. For Company Law, the relevant *acquis communautaire* consists of: (i) First Council Directive 68/151/EEC[34]; (ii) Second Council Directive 77/91/EEC[35]; (iii) Third Council Directive 78/855/EEC[36]; (iv) Sixth Council Directive 82/891/EEC[37]; (v) Eleventh Council Directive 89/666/EEC[38]; (vi) Twelfth Council Directive 89/667/EEC[39].

The Fifth Directive was meant to coordinate the safeguards, required by Member States of companies for the protection of the interests of members and others, within the meaning of the second paragraph of Article 58 of the Treaty, as regards the structure of *sociétés anonymes* and the powers and obligations of their organs[40]. This directive however, remained only a pro-

---

[34] First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for *the protection of the interests of members and others*, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (OJ L 65/8, 14.3.1968).

[35] Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for *the protection of the interests of members and others*, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of *the formation of public limited liability companies and the maintenance and alteration of their capital*, with a view to making such safeguards equivalent (OJ L 26, 31.1.1977, p. 1–13).

[36] Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3)(g) of the Treaty concerning *mergers of public limited liability companies* (OJ L 295, 20.10. 1978, p. 36–43).

[37] Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3)(g) of the Treaty, concerning *the division of public limited liability companies* (OJ L 378, 31.12.1982, p. 47–54).

[38] Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning *disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State* (OJ L 395, 30.12.1989, p. 36–39).

[39] Twelfth Council Directive 89/667/EEC of 21 December 1989 on *single-member private limited-liability companies* (OJ L 395, 30.12.1989, p. 40–42).

[40] *See* COM (72) 887 final, 27 September 1972. Bulletin of the European Communities Supplement 10/72.

posal**.** The ninth directive on affiliated undertakings, i.e. under law relating to groups of companies, has not even reached the proposal stage. Obviously, these two documents were not taken into consideration as relevant part of the *acquis communautaire*.

Within the last months of 2006, Law no. 31/1990 (Romanian Company Law) underwent significant modifications. These changes were meant to increase the compliance level of Romanian Company Law with EU legislation, especially EU Directives. Moreover, a so-called "yellow flag" was attached to this issue by the European Commission[41], a time, it must be remembered, that was one month prior to Romania's due accession date.

Thus, the urgently needed Company Law legislative reform was adopted by Law no. 441/2006[42], and included the following key amendments:

- revision of the constitutive deed's mandatory clauses, by reducing their number (according to First Council Directive 68/151/EEC);
- revision of the causes leading to company nullity (according to First Council Directive 68/151/EEC);
- new provisions on liability resulting from the failure to fulfil the requirements concerning the publicity of the company's incorporation and/or the necessary publicity during the company's existence (according to First Council Directive 68/151/EEC);
- creation of a basis for establishing the Trade Registry's electronic archive, which should provide information from the Trade Registry in electronic format and for company's electronic incorporation (according to First Council Directive 68/151/EEC);
- a new approach on contribution in kind evaluation (according to First Council Directive 68/151/EEC);
- enactment (for the first time in Romanian Company Law) of the "authorized share capital" concept (according to Second Council Directive 77/91/EEC);

---

[41] As results from the "National Legislative Priorities Program for Integration in European Union" (as per second semester, 2006), as of 13 February 2007, *Section A – Priority Drafted Laws* – which are already in parliamentary procedures in order to be adopted and which have to be finalize until 30 December 2006. Romanian version of this document available on: <www.mie.ro/_documente/armonizare/Program_legislativ_semII_2006_ro.pdf>.

[42] Legea nr. 441 din 27 noiembrie 2006 pentru modificarea şi completarea Legii nr. 31/1990 privind societăţile comerciale, republicată, şi a Legii nr. 26/1990 privind registrul comerţului, republicată [Law no. 441 from 27 November 2006 amending Law no. 31 – Company Law – and Law no. 26 concerning the Trade Registry], was published in the Romanian Official Journal no. 955 of 28 November 2006. The Law was enforced from 1 December 2006.

- clarifications on the concepts of "own shares buying"; "own shares subscription", as well as new clear provisions concerning this matter (according to Second Council Directive 77/91/EEC);
- legal definitions for mergers and spin-offs (according to Third Council Directive 78/855/EEC and Sixth Council Directive 82/891/EEC);
- revision of the mandatory clauses of the merger/spin-off plan and new provisions meant to provide a better level of protection for shareholders/partners and third parties (according to Third Council Directive 78/855/EEC and Sixth Council Directive 82/891/EEC);
- clarification of the concepts of "division by acquisition" and of "division by formation of new companies" – both known as "*desprindere*" in Romanian legal terminology (according to Sixth Council Directive 82/891/EEC).

Before continuing an analysis of the relevant Regulations on the Company Law, it is worth noting that Romania also transposed in 2006 the Directive 94/45/EC on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees[43]. Romania assumed this Directive by Law no. 217/2005[44] as amended in the same year[45].

It is worth taking into account that, before becoming a Member State, Romania had transposed some of the EU Regulations. It is not extremely accurate to state that "Regulations were transposed", but since Romania was not a Member State, the only way to apply EU legislation was through

[43] Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees (OJ L 254, 30.9.1994, p. 64–72).

[44] Legea nr. 217 din 5 iulie 2005 privind constituirea, organizarea şi funcţionarea comitetului european de întreprindere [Law no. 217 from 5 July 2005 concerning the establishment, the organization and functioning of the European Enterprise Committee], was published in Romanian Official Journal no. 628 of 19 July 2005.

[45] Law no. 217/2005 was amended by Ordonanţa Guvernului nr. 48 din 30 august 2006 pentru modificarea şi completarea Legii nr. 217/2005 privind constituirea, organizarea şi funcţionarea comitetului european de întreprindere [Governmental Ordinance (GO) no. 48 from 30 August 2006] and by Legea nr. 468 din 12 decembrie 2006 pentru modificarea şi completarea Legii nr. 217/2005 privind constituirea, organizarea şi funcţionarea comitetului european de întreprindere [Law no. 468 from 12 December 2006]. The latter act was published in the Romanian Official Journal no. 1028 from December 27, 2006 in order to transpose the following Directives: (i) Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees (OJ L 294, 10.11.2001) and (ii) Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees (OJ L 207, 18.8.2003).

the implementation of national legislation. This manner was also seen as a method of preparing the Romanian legal framework for the European accession.

With regard to Company Law, we mention Regulation no. 2137/85/EEC[46] on the European Economic Interest Grouping (EEIG), which was assumed by Romania under Title V of Law no. 161/2003[47] and Regulation no. 1346/2000[48], which was "transposed" by Law no. 637/2002[49]. After the date of its accession, Romania was confronted with the problem of double regulation on the same matter.

It is well-known that the Regulation is an EU act, which does not require transposition into a national legislation. It can be directly applied by all Member States. From this point of view, it is obvious that there is no need for a similar internal act on the same matter. Moreover, this doubling up could lead to disparities in administrative and judicial practice, in turn leading to a failure to fulfil the obligations assumed by Romania as a Member State (according to article 10 of Treaty on EU). As such, Romanian Government passed an Emergency Ordinance[50] in order to solve this problem. The Governmental Emergency Ordinance (GEO) no. 119/2006[51]

---

[46] Council Regulation 2137/85/EEC of 25 July 1985 on the European Economic Interest Grouping (EEIG) (OJ L 199, 31.7.1985, p. 1−9.

[47] Legea nr. 161 din 19 aprilie 2003 privind unele măsuri pentru asigurarea transparenței în exercitarea demnităților publice, a funcțiilor publice şi în mediul de afaceri, prevenirea şi sancționarea corupției [Law no. 161 from 19 April 2003 concerning some measures ensuring transparency in the exercise of public dignities, public functions and in the business environment, and for the prevention and sanction of corruption], was published in the Romanian Official Journal no. 279 from 21 April 2003.

[48] Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings was published in Official Journal, L 160 from 30.6.2000. (OJ L 160, 30.6.2000, p. 1–18).

[49] Legea nr. 637 din 7 decembrie 2002 cu privire la reglementarea raporturilor de drept internațional privat în domeniul insolvenței [Law no. 637 from 7 December 2002 concerning the regulation of the legally private international relationships in the domain of insolvency], was published in the Romanian Official Journal no. 931 of 19 December 2002.

[50] Government Emergency Ordinance (GEO) is a normative act issued by Government in order to react towards an emergency situation, which requests an extremely fast response. In fact, by utilizing this procedure, the Government is using its constitutional prerogative to legislate. Immediately after the GEO is adopted by the Government, it must be submitted to the Parliament. The final phase is the publication of the GEO in the Romanian Official Journal (*Monitorul Oficial al României*). As of the date of publication in the Romanian Official Journal, the respective GEO will be in force.

[51] Ordonanța de urgență nr. 119 din 21 decembrie 2006 privind unele măsuri necesare pentru aplicarea unor regulamente comunitare de la data aderării României la Uniunea Europeană [Government Emergency Ordinance (GEO) no. 119 from 21 December 2006 regarding some necessary measures for the application of some EU Regulations from the

partially repealed Law no. 161/2003 (Title V) and Law no. 637/2002 as well, and amended the regulations concerning EEIG and private international legal relationships regarding insolvency related to European companies.

b) Romanian Company Law and the EU Company Law after Romania's Accession

During the second period, from 1 January 2007 (when Romania became a Member State) until the time of writing (March 2009), Romania has constantly harmonized its legislation with the *acquis communautaire* based on the Treaty Establishing the European Communities (Treaty on European Union), which legally obliges Member States to transpose and/or apply European legislation.

First of all, we are going to discuss the *acquis communautaire's* transposition into Romanian legislation. This activity was structured on two basic components:

(i) Transposition of the amendments of Company Law Directives already adopted;
(ii) Transposition of the newly adopted Company Law Directives.

In 2007, Romanian Government passed a Government Emergency Ordinance (GEO) to amend the Law no. 31/1990 (Romanian Company Law). In fact, GEO no. 82/2007[52] was necessary because the late 2006 reform created some gaps in the company law framework, which needed to be remedied immediately. For instance: references were made to repealed articles; no legal terms were established for fulfilling new requirements – such as concluding management contracts between the joint-stock companies and their directors and more others.

Council Directive 2001/86/EC[53] supplementing the Statute for a European company with regard to the involvement of employees was transposed by Government Decision (GD) no. 187/2007[54].

---

date of Romania's accession to European Union], was published in Romanian Official Journal no. 1036 of 28 December 2006.

[52] Ordonanța de urgență nr. 82 din 28 iunie 2007 pentru modificarea şi completarea Legii nr. 31/1990 privind societățile comerciale şi a altor acte normative incidente [Governmental Emergency Ordinance (GEO) no. 82 from 28 June 2007, for the amendment of Law no. 31 – Company Law – and for the amendment of Law no. 26 concerning the Trade Registry], was published in the Romanian Official Journal no. 446 of 29 June 2007.

[53] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees (OJ L 294, 10.11.2001, p. 22–32).

In 2008, significant amendments to Law no. 31/1990 (Romanian Company Law) were passed by the Romanian Government. The same legislative procedure was chosen – a Government Emergency Ordinance (GEO). Thus, GEO no. 52/2008[55] was enacted to transpose the Tenth Directive 2005/56/EC[56] on cross-border mergers of limited liability companies. This modification of Company Law by GEO was considered necessary because Romania had run out of time: the dead-line for transposing this Directive (15 December 2007) had already passed. The Company Law was amended by inserting the new legal provisions provided by this Directive directly into the Law's text[57].

Considering that another intervention on Company Law would be needed in the future to transpose Directive 2007/63/EC[58], before its deadline of 31 December 2008, the Romanian Government decided that was better to complete the Company Law with one single amendment. Therefore, the same GEO eliminated the requirement for an independent expertise report for mergers or spin-offs, and for some of the joint-stock companies, provided that all shareholders and all security holders were able to participate in the decision making process.

The Parliament approved GEO no. 52/2008 and also made some small amendments through Law no. 284/2008, which was meant to transpose Directive 2006/68/CE[59], as regards the formation of public limited liability

---

[54] Hotărârea Guvernului nr. 187 din 20 februarie 2007 privind procedurile de informare, consultare şi alte modalităţi de implicare a angajaţilor în activitatea societăţii europene [Government Decision (GD) no. 187/2007 regarding the procedures of information, consultation and other means of involvement of employee in the activity of the Societas Europea], was published in the Romanian Official Journal no. 161 of 7 March 2007.

[55] Ordonanţa de urgenţă nr. 52 din 21 aprilie 2008 pentru modificarea şi completarea Legii nr. 31/1990 privind societăţile comerciale şi pentru completarea Legii nr. 26/1990 privind registrul comerţului [Governmental Emergency Ordinance (GEO) no. 52 from 21 April 2008, for the amendment of Law no. 31, Company Law, and for the amendment of Law no. 26 concerning the Trade Registry] was published in the Romanian Official Journal no. 333 of 30 April 2008.

[56] Tenth Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 *on cross-border mergers of limited liability companies* (OJ L 310, 25.11.2005 p. 1–9).

[57] Articles 251^2 to 251^{19} were added to Chapter III (named *Cross-Border Merger*) on Title VI (named *Winding-up, Spin-off and Merger of the companies*).

[58] Directive 2007/63/EC of the European Parliament and of the Council of 13 November 2007 amending Council Directives 78/855/EEC and 82/891/EEC as regards the requirement of an independent expert's report on the occasion of merger or division of public limited liability companies (OJ L 300, 17.11.2007, p. 47–48).

[59] Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital was published in (OJ L 264, 25.9.2006, p. 32–36).

companies and the maintenance and alteration of their capital. Once again, Romania was a little late in transposing this Directive exceeding the deadline of 15 April 2008.

The so-called Fourteenth Directive, in effect[60], will make it possible for companies to transfer their registered offices – their legal headquarters – to other locatiosn in the EU. Until now this was either impossible or required for the company to be liquidated in its country of origin before it could be re-founded with its registered office in the new country[61]. In Romania however this is not a matter of great discussion or interest in the business environment.

After becoming a Member State, Romania has constantly been concerned with the application of the *acquis communautaire*. For this reason, the Romanian legislation was receptive to the newly adopted EU company legislation. We mention here Council Regulation (EC) no. 2157/2001 on the Statute for a European company (SE)[62] and Council Regulation (EC) no. 1435/2003 on the Statute for a European Cooperative Society (SCE)[63]. By GEO no. 52/2008[64] were enforced several national provisions that are considered able to facilitate the application of the Regulation regarding SE (new title VII[1]of the above mentioned GEO) and Regulation concerning SCE.

The Fourth Council Directive 78/660/EEC[65] and the Seventh Council Directive 83/349/EEC[66] correlate with Section 2 of Chapter 5 – Company

---

[60] *See* also European Parliament Resolution of 10 March 2009 with recommendations to the Commission on the cross-border transfer of the registered office of a company.

[61] The Directive, if brought forward, would provide a legal framework for companies registered in the EU to transfer their registered office from one Member States to another. The Directive would make it possible, for example, for a German GmbH or Romanian SRL to transfer its registered office to the UK and at the same time transforms itself into a UK Ltd. That means that after the transfer of the registered office the company is organized by UK company law and no longer by German or Romanian company law.

[62] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the *Statute for a European company (SE)* (OJ L 294, 10.11.2001, p. 1–21).

[63] Council Regulation (EC) No 1435/2003 of 22 July 2003 on the *Statute for a European Cooperative Society (SCE)* (OJ L 207, 18.8.2003, p. 1–24).

[64] Ordonanța de urgență nr. 52 din 21 aprilie 2008 pentru modificarea şi completarea Legii nr. 31/1990 privind societățile comerciale şi pentru completarea Legii nr. 26/1990 privind registrul comerțului [Governmental Emergency Ordinance (GEO) no. 52 from 21 April 2008, for the amendment of Law no. 31 – Company Law – and for the amendment of Law no. 26 concerning the Trade Registry was], published in the Romanian Official Journal no. 333 from 30 April 2008.

[65] Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3)(g) of the Treaty on the *annual accounts of certain types of companies*. (OJ L 222, 14.8.1978, p. 11).

Accounting (Financial Situations) and were transposed into Romanian legislation. The Fourth Council Directive 78/660/EEC, as effective from December 2005 was transposed by Public Finance Ministry Order no. 1752/2005[67]. The final modification of the Fourth Council Directive[68] was immediately transposed into Romanian legislation by way of amending the Public Finance Ministry Order[69].

The Eighth Council Directive 84/253/EEC[70] was repealed with effect from 29 June 2006, by Directive 2006/43/EC[71] on statutory audits of annual accounts and consolidated accounts, which was transposed into Romanian legislation by Governmental Emergency Ordinance (GEO) no. 90/ 2008[72], amended a few months later by Law no. 278/2008[73]. The transposi-

---

[66] Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54 (3)(g) of the Treaty on *consolidated accounts* (OJ L 193, 18.7.1983 P. 1–17).

[67] *Order no. 1.752 from 17 November 2005* of Public Finance Ministry for the approval of the accounting regulations in conformity with the European Directives.

[68] Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (OJ L 224, 16.8.2006 p. 1–7).

[69] *Order no. 2.001 from 22 November 2006* of Public Finance Ministry for amending Order no. 1.752 from 17 November 2005 of Public Finance Ministry for the approval of the accounting regulations in conformity with the European Directives. One year later it was again amended by *Order no. 2.347 from 12 December 2007* of Economy and Finance Ministry [former Public Finance Ministry] for amending Order no. 1.752 from 17 November 2005 of Public Finance Ministry for the approval of the accounting regulations in conformity with the European Directives.

[70] Eighth Council Directive 84/253/EEC of 10 April 1984 based on Article 54 (3) (g) of the Treaty on *the approval of persons responsible for carrying out the statutory audits of accounting documents* (OJ L 126, 12.5.1984, p. 20–26).

[71] Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 *on statutory audits of annual accounts and consolidated accounts*, amending Council Directives 78/ 660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC (OJ L 157, 9.6.2006, p. 87–107).

[72] Ordonanța de urgență nr. 90 din 24 iunie 2008 privind auditul statutar al situațiilor financiare anuale şi al situațiilor financiare anuale consolidate [Government Emergency Ordinance (GEO) no. 90 from 24 June 2008 regarding the statutory audit of the annual financial statements and of the consolidated annual financial statements], was published in Romanian Official Journal no. 481 of 30 June 2008.

[73] Legea nr. 278 din 7 noiembrie 2008 pentru aprobarea Ordonanței de urgență a Guvernului nr. 90/2008 privind auditul statutar al situațiilor financiare anuale şi al situațiilor financiare anuale consolidate [Law no. 278/2008 from 7 November 2008 for the approval of (GEO) no. 90/2008 regarding the statutory audit of the annual financial statements and of the consolidated annual financial statements], was published in Romanian Official Journal no. 768 of 14 November 2008.

tion involved the amendment of Romanian common regulation concerning financial audit activity (provided by GEO no. 75/1999[74]), which is expected within the term stipulated by Law no. 278/2008 (until August 2009).

After all relevant Directives are transposed, we anticipate that the Romanian legal framework concerning accountancy and auditing will be fully prepared to receive further convergence between International Financial Reporting Standards (IFRS) and non-member country national GAAPs (Generally Accepted Accounting Principles)[75].

VIII. Relevance of Corporate Governance Codes

Following the example of all reputable capital markets, the Bucharest Stock Exchange (BSE) drafted its official Corporate Governance Code in late 2008[76]. The Code retains the principles and recommendations which have found general acceptance, and clearly follow OECD principles.

The Code's provisions are considered supplementary rules for existing legal norms, voluntarily assumed by listed companies and any close companies who choose to adopt the Code. The document combines all international trends by expressly providing a balance between the promotion of shareholder interests (shareholder value), shareholder rights (shareholder democracy) and employee interests (the latter appears because of the social responsibility requirement, rather than as result of the codetermination system)[77].

---

[74] Ordonanța de urgență nr. 75 din 1 iunie 1999 privind activitatea de audit financiar [Government Emergency Ordinance (GEO) no. 75 from 1 June 1999 regarding the financial audit activity] was published in Romanian Official Journal no. 256 of 4 June 2008 and than re-published in Romanian Official Journal no. 598 of 22 August 2003.

[75] On 6 July 2007, the Commission presented its first report to the European Securities Committee and to the European Parliament (*See* COM/2007/405/FINAL, Official Journal, C, 2007/191/20). Under *Regulation 1606/2002 of the European Parliament and of the Council of 19 July 2002* (the "IAS Regulation") companies listed on a regulated market of any Member State and governed by the law of a Member State of the European Union are required to apply IFRS as adopted by the EU ('endorsed IFRS') for their consolidated accounts for financial years starting from January 2005. This report focuses on the respective work timetables envisaged by national authorities of Canada, Japan and the USA for the convergence between *International Financial Reporting Standards* (IFRS) and their national *Generally Accepted Accounting Principles* (GAAPs). It also contains some preliminary information about the convergence efforts by some other third countries.

[76] The first draft of a Corporate Governance Code for the companies listed to BSE dated back 2004. It was merely a academic project and was never institutionally adopted.

[77] For a detailed presentation of the three models of corporate governance:

The vision and provisions contained in the code focus on company administration, including the functioning of the board, management control, internal and external monitoring, accountability to shareholders, and monitoring the rights of shareholders.

As in other Eastern and Central Europe countries, compliance with the Code by listed corporations is voluntary, and paired with the well-known "comply or explain" rule. Issuers adopting the Code wholly or partially must provide an annual Corporate Governance Compliance Statement to the BSE, in which they specify the recommendations of the Code they have implemented and in what manner. If the issuer fails to implement one or more recommendations, it must provide adequate information to explain its non-observance of the Code. The BSE determines when to disclose publicly when a company did not observe the Codes' provisions.

The most important issue concerning the Corporate Governance Code is the problem of enforcement. Except for the ability to disclose the companies which did not observe the Code recommendations, BSE is not vested with enforcement powers and the market does not provide any independent or governmental authority to sanction company misconduct. In other words, the Code does not exceed its limitations as an instrument of auto-regulation. Inaccurate corporate governance disclosures are difficult to detect or they may have hidden implications that are difficult to identify. For this reason, even if an authority were given the power to report irregularities and impose sanctions, it would still not have sufficient means to efficiently carry out its task[78]. In Romania's case, without an authoritative interpretation, there cannot be a uniform understanding of compliance and the explanations given for non-compliance explanations risk becoming redundant, or, in the best-case scenario, becoming insignificant or uninformative.

As a conclusion, purely voluntary codes paired with a weak "comply or explain" principle, do not offer a solution for the lack of normative authority: Romanian companies will follow code recommendations and report accurately on corporate governance solely if it is in their own interest. Nevertheless, without imposing a unique model, the Code could be consid-

---

(i) St. Nestor, J.K. Thompson, *Corporate Governance Patterns in OECD Economies: Is Convergence Under Way?*, available at: <www.pfsprogram.org/file.php?id=Three+Models+of+Corporate+Governance+-+January+2009.pdf>.

(ii) *Three Models of Corporate Governance from Developed Capital Markets,* available at: <www.oecd.org/dataoecd/7/10/1931460.pdf>.

[78] P.U. Ali, G.N. Gregoriou, *International Corporate Governance after Sarbanes – Oxley*, Wiley and Sons, New Jersey, 2006, p. 471.

ered as a fix for a number of "points of control" that have a national normative root[79].

IX. Relationship between Directors and Shareholders

The nature of the relationship between directors and shareholders is legally attached to the mandate contract, under the Civil Code and the Commercial Code. Company Law provides that directors' duties and liabilities are governed by the provisions regarding this mandate. Nevertheless, in Romanian legislation an inaccuracy persists concerning the principle's identity, as it is not clearly defined whether the mandate is granted by the shareholders or by the company itself.

The legal mandate approach is complimented by the doctrine of "the Body", according to which the Board is a Statutory Body of the Company, to whom the Shareholders, as owners, delegate the management of the Company and its representation. The principle stipulated by law is that "the administrators are jointly liable towards the company". In principle, only the company is entitled to file a liability action in front of the Courts of Law against the administrators. Third parties (such as the company's creditors), can only act against the directors in case of insolvency, and only if the director is responsible for the company's insolvent state.

In addition, under Romanian Law, directors do not owe a general legal or jurisprudential duty of loyalty to the stakeholders (employees, creditors, society). Even so, there are mandatory rules that assure stakeholder rights. It is accepted that Tax Law norms protect State interests, Labour Law norms protect employees or that commercial contracts and insolvency procedure protects creditors.

The general principle of director's duty of loyalty to stakeholders could form the object of a serious discussion in the context of the evolution of Corporate Governance or in the context of large companies' programs for social responsibility.

Representing the company is a key characteristic of company directors. This is why Romanian Company Law included the principle of making directors' actions binding[80]. This principle also incorporates the rule ac-

---

[79] See C. Gheorghe, *Dreptul pieței de capital* [Capital Market Law], C.H. Beck Publishing House, Bucharest, 2009, p. 273.

[80] Romanian Company Law provides that, in its relationships with third parties, the company shall become responsible for the acts concluded of its bodies even if these acts exceed the company's scope of business, except for the case where it proves that the third parties knew or had to know about its exceeding, or when the acts thus concluded exceed the limits of the powers provided by the law for such bodies. The publishing of the

cording to which the administrators who are entitled to represent the company cannot transfer this right, except where expressly permitted to do so by the shareholders.

X. Legal Transplants Related to Company Directors

1. Introduction of Fiduciary Duties

It is commonly known that the Anglo-American legal doctrine delimits the right and responsibilities of directors and managers vis-à-vis shareholders by using the core concept of fiduciary duties. These are a set of specific obligations and standards of conduct derived from the principle according to which the relationship between shareholders and directors is based on trust and confidence. The most widely accepted obligations derived from this concept are the duty of loyalty and the duty of care. In the U.S., these obligations have risen out of case law[81], while in the U.K., they are codified in The Companies Act (2006)[82]. The boundaries of managers' obligations to shareholders are inherently difficult to list exhaustively, as they include factual situations that cannot be foreseen and categorized[83]. These characteristics represent qualities in a legal system based on a judge-made law, but at the same time may be extremely difficult to transplant to other legal systems (especially those based on codified law), because the meaning of fiduciary duties can not easily be specified in a detailed legal document.

Among the alternative strategies which could be used by countries wishing to develop the institutional framework for substantial and effective enforcement of the fiduciary duties[84], the Romanian Lawmaker choose a structural transplant of these duties by completely transferring their implementation to black letter company law.

Romanian Company Law (amended at the end of 2006) provides that the members of the Board of Directors shall exercise their functions with the care and diligence of a good administrator. The members of the Board

---

Articles of Association alone cannot be taken as proof for being in the know. The clauses of the Articles of Association or the decisions taken by the statutory bodies of the company which limit the powers vested into them by the law, cannot be opposed to third parties, even if they have already been published.

[81] R. Flannigan, "Fiduciary Duties of Shareholders and Directors", *Journal of Business Law*, 2004, p. 277.

[82] According to art. 174 to 177 of Companies Act (2006).

[83] R.Ch. Clark, *Corporate Law*, Little Brown & Co., Boston, 1986, p. 141.

[84] K. Pistor, C. Xu, "Fiduciary Duty in Transitional Civil Law Jurisdictions. Lessons from an Incomplete Law Theory", *European Corporate Governance Institute* (*ECGI*), Law Working Paper no. 1/2002, p. 5.

shall also exercise their term of office with loyalty, in the company's interest. They are not allowed to disclose confidential information and business secrets of the company, to which they have access in their capacity of administrators. This obligation applies even after their term of office as administrator, according their management contract. These legal provisions are meant to codify the duty of care and skill[85], the duty of loyally acting to the company's best interests and the duty of confidentiality, as the core structure of the fiduciary duties.

This reform should bring an added value to the Romanian corporate law for two important reasons: (i) it has conceptualized some duties that were identified before 2006, through a flexible and extended interpretation of the Romanian Civil and Commercial Code provisions concerning the good-faith principle, the mandate agreement and other similar civil law institutions (*negotiorum gestio*); (ii) it offers the courts of law an express legal reference on which their decisions can be grounded. Before 2006, the ignorance of law practitioners and the reticence of the Courts to conclude and enforce an obligation without a legal or express contractual provision resulted in an almost complete lack of decisions against directors on this basis.

Nevertheless, the Romanian Lawmaker chose to transplant also the complementary principle known as "the business judgment rule", by almost literally importing it from the definition given by the U.S. Delaware Supreme Court[86]. According to art. 144^1 (2) of the Company law, the administrator does not break its duty of care if, at the time of making a business decision, he is reasonably entitled to consider that he acts in the company's interest and based adequate information[87].

---

[85] The standard of appreciation of fault is medium, *in abstracto*, considering a careful and conscious manager.

[86] See, for instance, *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971) where the Delaware Supreme Court did not want to substitute its own notions of what is or is not sound business judgment if "the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company".

[87] The business judgment rule creates a strong presumption in favor of the Board of Directors of a corporation, freeing its members from possible liability for decisions that result in harm to the corporation. The presumption is that "in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation's best interest." In effect, this presumption makes officers, directors, managers, and other agents of a corporation immune from liability to the corporation for loss incurred in corporate transactions that are within their authority and power to make when sufficient evidence demonstrates that the transactions were made in good faith and based on prior adequate information.

The Romanian legislator did not pay sufficient heed to the interpretation of the business judgment rule in American courts, which reflects the doctrine of courts non-interference in business decisions. American courts do not hold directors liable for bad business decisions made without conflict of interest, unless those decisions are completely irrational. Rather, American case law considers the constraints which make managing a company difficult, rather than the effect of a decision (market competition, incentive compensation, managerial culture etc). This great tolerance inherent in the business judgment rule may not fit with the overwhelming need in the Romanian legal order to impose an efficient system of duties and liabilities on the company directors and managers. This well-intentioned and economically advantageous legal transplant may become a success story only after the Romanian courts gain experience in clearly determining the conceptual frontier between the business judgment rule as legal presumption of non-liability, and the same rule as an exception from the principle of directors' liability for lack of care and diligence.

2. A Clear Separation between Management and Control Functions of the Board of Directors

For sixteen years after its enactment, Romanian Company Law (as legal text and legal doctrine) ignored the contemporary international preoccupations with the improvement of corporate governance as a way to efficiently organize Board structure and functions.

The Board of Directors was conceived as a management body without any concern being given to clear regulation of control within the management body and to the distinction between the executive and the non-executive members of the Board.

After the 2006 Reform, Romanian Company Law provided that where the delegation of management powers occurs in a joint stock company, the majority of the members of the Board shall be made up of non-executive directors. This reform also introduced the concept of the "independent director"[88], completely overlooked by Romanian legislation by that time. According to article 138^2, the Articles of Association of a company or the general meeting of shareholders may provide or decide that one or more members of the Board must be independent. Using an independent director is also optional for public listed companies and those who benefit from special regulation (such as credit institutions, insurance companies or intermediaries on the capital market). Unlike international corporate governance codes (e.g. UK Combined Code on Corporate Governance), the

[88] D.C. Clarke, "Three Concepts of the Independent Director", in *Delaware Journal of Corporate Law*, vol. 32, p. 73–111.

Code adopted in 2008 by the Romanian Stock Exchange does not provide an exception from general legal provisions and keeps the nomination of an independent director as optional for listed companies.

The same recent reform introduced the possibility for the Board of Directors to create consultative committees made up of at least two Board members charged with the conduct of investigations and the development of recommendations for the Board regarding audits, remuneration and nomination of candidates for management positions. At least one member of this committee must be an independent non-executive director (except for the audit committee and remuneration committee, which must be formed exclusively of non-executive administrators).

Almost three years after the company law reform, these three new concepts are still far for finding their way to successful implementation. The non-executive Board members were formally introduced in order to comply with Board structure regulation. However, they do not have efficient instruments and procedures to assure the control over the directors empowered with management functions and do not benefit from a separate regime of civil liability to encourage them to assume specific decisions and positions within the Board. These concepts were imported from legal systems where one-tier administration system is fully compatible with corporate governance regulation and principles, but they did not find fertile ground in Romanian practice.

The same conclusion could be made concerning the independent director concept, in practice the least used. One of the reasons for this is the ownership structure of most Romanian joint stock companies, which are subsidiaries of international corporations and groups. The latter do not manifest particular interest in using independent members in Romania, preferring to use this concept only on the Board of the parent company.

3. The German Two-Tier Administration System: A New Legal Transplant

The Company Law reform introduced the two-tier administration system (Supervisory Board and Management Board), the German model for joint stock corporate administration for the first time in the Romanian legislation in 2006[89]. The two-tier system was adopted as an alternative to the traditional one-tier system (Board of Directors) and consequently, Romanian joint stock companies are entirely free to choose between one of the models, following once again the choice of the French legislator[90]. Only

[89] K.J. Hopt, P.C. Leyens, "Board Models in Europe. Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy", *ECGI*, Law Working Paper no. 18/2004, p. 4.

[90] Yv. Chaput, A. Levi (coord.), *La direction des sociétés anonymes en Europe. Vers des practiques harmonisées de gouvernance*, Litec, 2009, p. 16.

time shall reveal the practical success of the German traditional model transplant, which presumably depends upon the efficiency of corporate governance for listed joint stock companies with German or Austrian controlling shareholders.

XI. Shareholders' Rights

Although numerous key amendments to the initial Company Law no. 31/1990 had already been introduced by the significant reforms of 1999 and 2003[91], the current content and structure of shareholders rights were established in 2006, when the legislator passed Law no. 441/2006, with the intention of bringing Romanian legislation in line with all EU Directives (especially the first and second Council directives) and to assure the compatibility of Romanian legislation with OECD Principles of Corporate Governance[92].

Shareholders' rights, including those specific to minority shareholders, can be divided[93] into two major groups: (1) *patrimonial rights* and (2) *extra-patrimonial* or *political rights*.

1. Patrimonial Rights

Patrimonial rights are those with an economic or pecuniary character. In other words, those prerogatives granted to the shareholders that have a clear economic context, which can be measured or estimated in money. Among the patrimonial rights, the most representative one is the right to dividends paid to the shareholders according to Company Law: in proportion with their quota of the registered and paid capital, unless the Articles of Association provides otherwise[94]. This category of rights also includes the right to a quota allocated to each share from the company's asset distribution in the

---

[91] For details, see St. Cărpenaru, C. Predoiu, S. David, Gh. Piperea, *Legea societăților comerciale. Comentariu pe articole,* [Company Law. Comments by articles] 2nd edition, C.H. Beck Publishing House, Bucharest, 2009, p. 9.

[92] As outlined by the PAL II – Program The Programmatic Adjustment Loan of the World Bank.

[93] For proposals on shareholders rights classifications, See C. Duțescu, *Drepturile acționarilor* [Shareholders' Rights], C.H. Beck Publishing House, Bucharest, 2007, p. 7.

[94] According to Romanian Company Law, the dividend must be paid within the deadline established by the general assembly of shareholders or, as the case may be, established by special laws, but not latter than 6 months from the date when the annual financial statement related to the closed financial year was approved. For listed companies, the Capital Market Law provides that dividend must be paid within 60 days from the date the General Meeting of Shareholders' Resolution establishing the dividends is published in the Official Gazette of Romania.

case that the company is liquidated, and the right to legally dispose of the shares, by selling them or pledging them under a security arrangement.

The preference right for subscriptions in capital increases is another significant patrimonial shareholder right. It may be limited or even withdrawn by a majority vote at an extraordinary general meeting of shareholders attended by shareholders representing three quarters of the subscribed registered capital. The board of directors must make a written report available stating the reasons for limitation or of withdrawal of the preference right. This report should also explain how share values will be determined.

The same special quorum of three quarters of the total number of voting rights is also requested for listed companies, but in this case the Capital Market Law provides that the withdrawal of a preference right must be decided by a qualified majority of ¾ of the capital represented at the meeting.

2. Non-patrimonial Rights

Shareholder rights whose value cannot be expressed in money are usually called non-patrimonial or political rights. These prerogatives can be broadly divided into three categories: (i) rights to access information related to the company; (ii) rights to investigation and monitoring of the management and (iii) voting rights.

Information represents an individual shareholder right without any restriction on the number of shares held. It is exercised by imposing correlating obligation on the issuing company. Notice of the general meeting of shareholders must be published in the Romanian Official Journal and in one of the local or national newspapers, at least 30 days prior to the meeting (25 days, in case of listed companies). If the company has a web page, the convening notice must also be published on the site, in order to ensure free access to the information for company shareholders. The company must allow shareholders to consult relevant documents (reporting, financial statements) at least 15 days before the general meeting of shareholders, with any shareholder being entitled to receive copies of these documents, with no other fee except the cost of copying them.

Any shareholder is entitled to submit written questions regarding the company's activity, before the date of the general meeting. The answer should be provided to the relevant shareholder at the meeting or even before, if the company has a web page. Any interested shareholder is entitled to ask for information regarding the outcome of a vote on a general meeting resolution.

Unfortunately, infringement of information rights does not benefit from an effective sanctioning regime. Civil law sanctions may be enforced with difficultly, as a general meeting resolution can only be nullified when the

claimant proves the resolution would have been different if information was duly given[95]. It is true that information is traditionally related to the parties' duty to facilitate the performance of the company contract, in order to ensure contractual performances. However, today the right to information has detached itself from its contractual roots in order to become a simple technical instrument of legal protection for shareholders. This reality has generated a shift from the contractual origins of the right to information towards a more administrative right.

That explains why the sanctions for infringements of information rights are less effective and the intervention of the National Securities Commission is needed. This authority is able to enforce a fine of a significant amount (between 0,5 to 5% of the registered share capital of the listed company). Also, the Bucharest Stock Exchange can publicise the company's breach of duty to inform the market.

The investigation of management operations is generally viewed as *a collective prerogative*. Any shareholder is entitled to report facts considered to appropriate for censure to the auditors. The auditors shall take this into consideration when drawing up the report to the general shareholders' meeting (GSM). However, the internal auditors are only obliged to carry out this verification if the claim comes from shareholders holding 5% of the share capital.

One or more shareholders representing, individually or together, at least 10% of the registered capital have the right to ask the Court of Law to appoint one or several experts, to analyse certain aspects of the company's management and to submit a report to the shareholders, the Board of Directors and to the censors or internal auditors of the company, as applicable, for evaluation and appropriate action. The board must include the expert report on the agenda of the next general meeting of shareholders.

The monitoring of management is also organized as a collective shareholders prerogative.

Bringing an action for damages against directors, the Directorate or the Supervisory Board is considered to be a social action, so the competence for bringing action in directors' liability defaults to the general meeting of shareholders. As a remedy, if the general assembly does not decide to bring the action for responsibility against the directors and does not positively answer to one or more shareholders' proposal to initiate such an action, shareholder(s) representing at least 5% of the registered capital are entitled to bring an action for damages, on their own behalf, but in the

---

[95] *See* R.N. Catană, *Dreptul societăților comerciale. Probleme actuale privind societățile pe acțiuni*, [Company Law. Actual Issues Concerning The Joint-Stock Companies], Editura Sfera Juridică, Cluj-Napoca, 2007, p. 10.

name of the company. Where a case is successfully filed, the claimant shareholders are entitled to a refund of court costs from the company.

The Company Law provides that the Board of Directors is obliged to convene the GSM immediately upon the request of shareholder(s) representing at least 5% of the registered capital. Furthermore, if the Board does not convene the general meeting within 30 days of the shareholders initiative, the claimants can be authorized by the Court (summary judgment procedure) to convene the meeting themselves and to establish its agenda.

Shareholders with at least 5% of the share capital or voting rights have the right to request the introduction of additional points on the general meeting agenda, within maximum 15 days of notice being published. The agenda, supplemented by the points proposed by the shareholders must be republished at least 10 days before the general assembly.

3. Enhancing shareholder democracy by modernizing voting rights

Voting rights in Romania are generally consistent with the highest level required by EU law. For instance, it offers a proper "one share – one vote" rule without any possibility of granting more than one vote per share (unlike France or Netherlands), but with the option to limit the number of voting rights to shareholders holding more than a certain threshold of the capital or number of shares.

Voting by proxy also benefits from a liberal approach[96]. Any shareholder is entitled to participate in the general meeting and to exercise voting rights, without any restrictions based on the number of shares owned. Any person can be given a mandate to vote on behalf of a shareholder. The only significant limitation is that the proxy (mandate, procuration) must be submitted to the company's general meeting secretary at least 48 hours prior to the meeting, or the right to vote is lost.

The possibility to vote electronically is legally granted without any formalities or restrictions, provided it is permitted by the company's articles of association.

After the reform from 2006, voting agreements benefited from a more relaxed regulation. Shareholders are free to agree on how they will vote, as long as they are not obliged to exercise their vote according to the instructions given by the company or its management. An agreement of this kind would be considered null and void.

Since November 2006, Romanian corporate law has probably provided the lowest quorum and majority rules for adopting resolutions at the general meeting of shareholders. The present form of the Romanian Company

---

[96] For details see, C. Duțescu, *Drepturile acționarilor* [Shareholders' Rights], 2nd Edition, C.H. Beck Publishing House, Bucharest, 2007, p. 274.

Law requires shareholder attendance of at least one fourth of the total number of rights to vote, for both ordinary and extraordinary meetings of shareholders. Where a second extraordinary general meeting of shareholders is held, it must be attended by shareholders with at least one fifth of the total number of rights to vote.

The simple majority of the votes represented at the meeting shall make the decisions, for both ordinary and extraordinary meetings. An extraordinary decision to change the main scope of business, to reduce or increase the registered share capital, to change the legal status, to merge, divide or dissolve the company must be passed with a majority of at least two thirds of the votes represented at the meeting.

Higher requirements of quorum and majority may be stipulated in the Articles of Association.

These provisions may be seen as a significant improvement in shareholder democracy by decreasing the legally required quorum and majority for adopting resolutions at the general meeting of shareholders. In addition, the new requirements are meant to facilitate decision-making and avoid supplementary costs generated by the need for future additional meetings. Nevertheless, decreasing the legal quorum has the associated disadvantage of not necessarily representing the company's legal will, and of increasing the risk of simultaneous general meetings, especially in companies with a dispersed ownership and conflicts between board members.

4. Reorganization of Dismissal of Board Members: A Controversial New Legal Transplant

The Company Law Reform from 2006 also marked a significant evolution concerning shareholder control over directors.

Prior to the reform, it was widely accepted that shareholders had the right to dismiss directors at any time for any reason without notice, based on the *ad nutum*[97] revocation principle, which governs the *intuitu personae*[98] mandate relationship according to the Romanian Civil and Commercial Codes. This dismissal by "a show of hands" was diffidently challenged

---

[97] *Ad nutum* means "at a simple sign", immediately and without any justification. This expression evokes, in the French based theory of the civil mandate, the possibility of a principal to revoke his agent at any time and without specific limitations or formalities. The theory was receipted in Romanian civil law – see St. Cărpenaru, L. Stănciulescu, V. Nemeş, *Contracte civile şi comerciale* [Civil and Commercial Contracts], ed. Hamangiu, Bucharest, 2009, p. 366.

[98] A particular legal relationship is *intuitu personae* when one party intended to conclude that operation (agreement) by expressly taking into consideration the personal characteristics of the other party. In such situations, the personal features of an individual tend to be the fundamental cause of the other party's wish to conclude the agreement.

by legal doctrine and jurisprudence, based on the acceptance of the French practice concerning abusive dismissal, when the director is removed under circumstances characterized as vexatious or with an unlawful refusal of the possibility to defend.

The new legal provisions specifically entitled directors and managers to claim damages where dismissal supervenes for unjustified reasons. Although these new provisions are inspired by the widely accepted doctrine of good faith, one could reasonably expect this transplant to reduce the enforceability of the traditional free revocation principle, which represents the highest form of expression of shareholder control over management. Given the well-known practice of establishing significant compensation clauses in favour of directors revoked before their contracts have come to an end, the expected effect of these new legal constrains will increase the costs of electing managers and will decrease the rights of shareholders against directors. Neither of these effects are well regarded in a developing market economy, where the company owners culturally prefer to keep the highest control of the business.

XII. Shareholder's Remedies

Article 134 of the Romanian Company Law entitles any shareholder that did not vote in favor of a GSM Decision to withdraw from the company. At the same time, the shareholder has the right to request the company to purchase the shares it owns. The right is not an absolute, the Law expressly provides the circumstances when a shareholder may withdraw from the company. The Law uses the criteria of the GSM Decision's object for determining these particular situations: (i) changing the company's main scope of business; (ii) moving the head office of the company abroad; (iii) changing the company's legal form or (iv) conducting a merger or division of the company. For the first three situations, the withdrawal right may be exercised within 30 days as of the date of GSM Decision's publication in the Romanian Official Journal. For the merger or division of a company the right must be exercised within 30 days as of the date of adoption of the GSM Decision.

The price of the shares to be bought out must be ascertained by an independent authorized expert, based on the average value resulting from the application of at least two evaluation methods provided by law. The Board of Directors will request the judge delegated by the Companies Trade Registry to appoint an expert, in accordance with all relevant provisions. The company is obliged to cover all evaluation costs.

The most significant remedy granted to shareholders is the possibility to claim the cancellation of the general meeting of shareholders' decisions.

The majority voting principle means that the legal will of the company coincides with the will of those shareholders that own a majority (simple or qualified) of the shared capital or of the voting rights. This is the main pillar of the legal construction of a company, seen as an institution that has to be functional and easily governed, even if it comes at the cost of renouncing private law contractual principles (*mutuus consensus – mutuus dissensus*). The decisions adopted on a majority basis by respecting the law and the Articles of Association are compulsory for all shareholders, even for those shareholders who did not take part in the meeting or who voted against them.

GSM Decisions that are contrary to the law or to the company's Article of Association can be challenged in court.

If relative nullity[99] is invoked, this action can be filed by any of the shareholders who did not take part in the GSM or who voted against the decision and requested their vote be mentioned in the GSM's minutes. The action must be registered within a 15 day period from the date the decision was published in the Romanian Official Journal. Third parties (including authorities) cannot claim cancellation on grounds of relative nullity.

If absolute nullity is invoked, the right to request cancellation of the GSM decision is imprescriptible and, according to the legal regime of this nullity, any person concerned may formulate a request at any time after the decision is adopted. However, the members of the Board of Directors or of the Supervisory Board are not entitled to request the cancellation of a GSM decision regarding their own dismissal.

The action in nullity must be instrumented by the court of law under non-public procedure, in a court chamber.

Along with bringing the action for cancellation, the plaintiff may request the court to adjourn by presidential ordinance (summary court order) the putting into effect of the decision that is being sued. The president of the Court may order the plaintiff to pay some form of financial payment.

Romanian Company Law also offers remedies in case of fraud against minority shareholders. Even before the reform of 2006, the theories of *abus de droit* (rooted in the private law) and of *power abduction*[100] (rooted

---

[99] The Company Law follows the Civil Law distinction between the absolute nullity reasons (infringement of norms protecting the general interests and public order) and the relative nullity (generated by breaching norms which protect personal interests of parties participating to a certain legal act).

[100] E. Gaillard, *Le pouvoir en droit privé*, Economica, Paris 1985, no. 172. In Company Law, the power give to majority shareholders is considered abducted whenever the company's and shareholders' legitimate interests to benefit from the operation of a prosperous firm are violated through a decision of the General Meeting. See D. Schmidt,

in the public law, applied in modern private law) used to prevent majority shareholders from exercising their voting rights against the company interests and undermining the legitimate interests of other categories of shareholders, by exclusively favouring the majority's own interests. An inspired law doctrine and praetorian jurisprudence considered the subjective right to vote is legally granted for achieving company goals and promoting its interests. Since exercising the vote ignores this particular goal and is also detrimental to the minority, the majority acting not in good faith must assume its civil responsibility. In order to recover reparation in kind[101] of the damage caused to the company and/or the minority shareholders, the general Assembly decision reached under these circumstances will be invalided by the Court.

Since 2006, both Law no. 31/1990 and Law no. 297/2004 possess specific provisions related to the abusive exercise of voting rights[102]. According to these, shareholders have a *duty to exercise their rights in good faith, by respecting the rights and legitimate interests of the company and other shareholders.* With these new provisions, Courts now have of a black letter norm with a view to justifying the cancellation of abusive shareholder meeting resolutions as an effective remedy to the defrauded (minority) shareholders.

Although Romanian Company Law possesses modern substantial norms for remedies granted to shareholders, this is not the case for procedural remedies. In this case, Romanian law faces a lack of preventive procedures, such as the possibility to obtain court orders, to obtain injunctions or to register court motions. In other words, the company law offers *a posteriori* remedies for situations when management decisions and shareholders resolutions are *lato sensu* illegal, but it almost completely ignores a priori measures and procedures which could prevent illegal decision making. For instance, preventing or suspending a possibly illegal general meeting of shareholders is practically impossible, claimants have to wait for the resolution to be made and seek its cancellation, with the significant risk that this resolution produces some adverse effects in the business environment. This issue of efficiency (at least with regards to oppressed minority reme-

---

Les conflits d'intérêts dans la société anonyme, Joly, Paris 1999, p. 190; idem., "De l'intérêt social", *JCP* ed. E 1995, p. 361; P. le Cannu, "Légitimité du pouvoir et efficacité du contrôle dans les sociétés par actions", Bull. Joly 1995, p. 637.

[101] In application of art. 998–999 of the Romanian Civil Code, the reparation in kind is preferred to the compensation, as long as it is possible. Thus, the cancellation of a general meeting resolution could be the most effective reparation in, especially when the resolution did not produce significant effects in the business environment.

[102] *See* article 136 (1) of Company Law no. 31/1990 and article 210 of Capital Market Law no. 297/2004.

dies) explains the lack of shareholders activism in Romania and the lack-lustre pursuit of personal rights and interests[103].

Indeed, legal practice shows Romanian shareholders are rather inactive and less persistent in defending their rights, especially before an abusive majority. The reduced numbers of cases brought to court could be explained by cultural psychological characteristics generated by the free mass privatization system and the lack of liquidity on the financial capital market. The low degree of shareholder activism can also be explained by the lack of preventive procedures granted under Romanian law. In many cases, the cancellation of a general meeting resolution is obtained only after months or years of litigation, long time after these resolutions have produced effects in the business environment. For this reason, the late cancellation of a resolution or belated procurement of compensation is useless for the claimant.

For this reason, any reform concerning shareholder remedies should be oriented toward the implementation of particular procedural instruments to offer, *ex-ante,* efficient protection to shareholders who can prove *prima facie* that the company's resolutions and decisions are in breach of the law or the articles of association. In other words, Romanian Corporate Law needs procedures like injunctions or summary judgments, which allow a claimant to efficiently block the implementation of a decision made under a persistent cloud of reasonable doubt.

---

[103] Unfortunately, there is no serious and unitary practice on matters concerning the protection of minority shareholders rights (like suing the decision-makers for fraud on the minority or demanding judicial expertise of specific management operations). But it is notable this inconvenience is not due only to the jurisprudence – the shareholders and their lawyers are apparently not ready to claim with success such rights. The OECD report on the Corporate Governance in Romania (2001) shows *some reasons* for witch the *shareholders could be so passive*:

− most shareholders are not familiar with their rights as shareholders and do not fully understand the corporate governance system in their companies;

− it is practically impossible for shareholders to organize themselves because of the large number and variety of persons involved (mass privatization);

− the free distribution of shares to the population during 1995 may have fostered a passive attitude among shareholders that tend to be grateful or indifferent;

− the costs for small individual shareholders to get involved in corporate governance are much higher than the benefits they would eventually derive from their activism.

XIII. Company Law Related to Capital Market Law

Law no. 31/1990[104] (Romanian Company Law, RCL) represents the common legal regime (general law) applicable to any Romanian company, while Law no. 297/2004[105] (Romanian Capital Market Law, RCML) contains special provisions concerning the legal relationships related to activities and participants in the capital market (special law – *specialia generalibus derogant*). RCL and RCML are, in principle, complementary and compatible, as seen in the manner which the RCML develops the RCL "reference legal norms" related to joint stock companies and legal texts it contains providing express waivers or default rules related to the certain provisions of RCL.

RCML contains numerous default rules regarding the incorporation of a company participating in a capital market, the shares of a company participating in a capital market and the operation and duties of managing bodies of a company participating in a capital market.

The most significant default legal norms refer to the transparency that ensures investors' confidence and integrity in a capital market. The first pillar of transparency is based on specific shareholders right to information. The second pillar is related to the protection of potential investors' right to information, reflected in the company's duty to inform the market.

Shareholders' right to information was conceived as a fundamental right, which has a contractual origin (as an element of the *affectio societatis*, which is the basis of the business association) and was meant to ensure the exercise of shareholder rights to control the company. Nevertheless, today, shareholder rights to information have become an essential instrument for protecting minority shareholders and capital market confidence, according to the principle of equality of chance between the investors. RCML provides that issuers must provide shareholders with all the information necessary to exercise their rights. Shareholders must be informed on all issues that are going to be discussed by the GSM at least 5 days before the General Meeting's date. The National Securities Commission (CNVM) may grant exceptions from this publication requirement to issuers for some information, or may oblige the issuer to publish privileged information it retained, with a view to ensuring the ordinate function of the market.

---

[104] Legea nr. 31 din 16 noiembrie 1990, Legea societăţilor comerciale [Law no. 31 from 16 November 1990, Company Law] was published in Romanian Official Journal no. 126–127 from 17 November 1990. The ultimate re-publication was in Romanian Official Journal no. 1066 from 17 November 2004. Its last amendment was dated 8 April 2009.

[105] Legea nr. 297 din 28 iunie 2004 privind piaţa de capital [Law no. 297 from 28 June 2008, Capital Market Law], published in the Romanian Official Journal no. 571 of 29 June 2004. It was never re-published. Its last amendment dates 25 April 2006.

Listed companies must perform specific formalities of publicity[106]:

- via mandatory special, current and periodical (quarterly, biannual and annual) reporting addressed to the bodies of the market (Bucharest Stock Exchange) and to the market authority (CNVM);
- via national media announcements and issuers' web pages;

The content of the information is also more specific than in the case of a regular closed company. It concerns any corporate events with a significant impact on the market[107], reporting on management remuneration and their deals with the company, etc.

Under RCML, transparency is also assured by the investors duty to publicly inform the market when they obtain privileged information, when exceeding thresholds (5%, 10%, 20%, 33%, 50%, 75%, 90%), in case of public tenders procedures (prior approval by CNVM and publicity of prospectus) etc. Special publicity is mandatory when buy-out and squeeze-out procedures are being used (in cases when shareholder structure allows a shareholder acting individually or in concert to hold more than 95% of the share capital or voting rights or after a takeover bid was promoted with an at least 90% success rate).

[106] For details see Cr. Gheorghe, *Dreptul pieței de capital* [Capital Market Law], C.H. Beck Publishing House, Bucharest, 2009, p. 202.

[107] Events such as holding a general meeting of shareholders, amendments to the Articles of Association (which must by priory approved by CNVM), conclusion of commercial agreements exceeding a certain value etc. must be publicly communicated in no more than 48 hours. For details, see articles 224, 226, 227 and 232 of RCML.

Company Law in Hungary

ANDRÁS KISFALUDI

Company law is a branch of law allowing for the role and importance of legal transplants to be studied properly for at least two reasons. Firstly, in the global economic system, international economic relationships are mainly characterised by exchanges between and the establishment of groups of companies. Secondly, the vehicle of the company is generally used in the circulation of working capital. For these reasons companies are heavily exposed to foreign influence, and national legal regulations for companies frequently become targets of legal transplants in order to facilitate international relationships between companies. Though there is no absolute and straightforward correspondence between the direction of movement of goods and capital in the economy and that of legal institu-

tions, it can still be generally observed that emerging economies new to the global economic system import not only goods, services, technologies, capital, but also "legal products", legal institutions to be transplanted into their legal system. Therefore, the study of legal transplants in these countries may provide an enlightening insight.

In this paper, a general overview on Hungarian company law system (Chapter I) will be given, followed by a description of the process of company law codification (Chapter II), then turning to specific company law matters, some examples of legal transplants in Hungarian company law legislation (Chapter III) will be provided. The remaining part of the paper deals with theoretical questions of legal transplants (Chapter IV).

I. The Hungarian Company Law System – a Brief Survey

In order to gain a general overview of the Hungarian corporate system one should take into consideration not only the companies in their narrow, technical sense,[1] but all types of business associations. This could be justified by the fact that these organizations have identical economic functions (at least on a relatively high level of generality)[2] and are regulated in a common code, where general rules are applied to all kinds of business associations irrespective of the size or the type of the specific organization.

Currently there are four types of business association in Hungary: business partnership, limited partnership, limited liability company and the company limited by shares.[3] These organization types give the organizational framework for the great majority of the national economy. Both in terms of numbers and economic power, business associations are the most important forms of economic organizations.[4] While the number of sole entrepreneurships could be comparable, the capital owned by the entre-

[1] In this case only the companies limited by shares or perhaps limited liability companies could be addressed.

[2] The common economic function features the pursuit of primarily economic activity, and organizing factors of production owned by different persons into organizations distinct from their members for this purpose.

[3] The Hungarian terms for the above mentioned types of companies are the following (cf. the German equivalents): közkekreseti társaság (business partnership) (*offene Handelsgesellschaft*), betéti társaság (limited partnership) (*Kommanditgesellschaft*), korlátolt felelősségű társaság (limited liability company) (*Gesellschaft mit beschränkter Haftung*), részvénytársaság (company limited by shares) (*Aktiengesellschaft*).

[4] According to statistics, on 1 January 2009, 5,901 business partnerships, 192,634 limited partnerships, 265,511 limited liability companies and 4,383 companies limited by shares were registered in Hungary.

preneurs is much smaller than the wealth handled by companies, therefore, their economic importance cannot be measured against that of companies.

There is a further type of economic organization, namely the co-operative. This form was traditionally treated as a kind of commercial company, but contemporary company law legislation has not qualified co-operatives as companies, providing instead separate legal regulation,[5] therefore, company law regulations do not apply to them.[6]

Company law legislation differentiates between public and private companies limited by shares. The dividing line between these subtypes is whether they issue shares to the public or not. The company law rules are basically the same for both types of companies limited by shares, but public companies must observe additional regulations – partly within company law and partly under capital market law – in order to counterbalance the potential risks involved with the public issuance of shares, and to provide satisfactory guaranties to investors. Positive law does not define the notion of public issuance. Capital market law regulation circumscribes in detail the private placement of securities,[7] then declares that any other issuance of securities – whether or not it happens through a stock exchange or an organized market – shall be treated as public issuance.[8] It follows that the shares of public companies limited by shares are not necessarily listed on a stock exchange or traded in any other publicly organized market. Consequently, the group of public companies can be further divided into two subgroups: listed and non listed companies. The legal regulation of these categories of companies does not differ extensively, but – as a matter of course – listed companies must observe the rules of the stock exchange where their shares are traded (e.g. listing requirements, trading and accounting rules, disclosure rules, etc.).

It is a new development in Hungarian company law that the Companies Act allows the formation of non-profit business associations. These organizations do not constitute a separate type of company; any company form can pursue for-profit and non-profit activity. A non-profit business asso-

---

[5] 2006. évi X. törvény a szövetkezetekről (Act No. X of 2006 on Co-operatives).

[6] There were some proposals to acknowledge co-operatives as one type of business associations and integrate them into the company law legislation, but these attempts have failed so far. The main reason for this was that socialist co-operatives had unresolved ownership problems after the changes at the beginning of 90s, and the legislator did not want to burden company law regulation with these problems.

[7] 2001. évi CXX. törvény a tőkepiacról (Act No. CXX of 2001 on Capital Market; hereinafter referred to as Capital Market Act), Section 14. The amount of securities to be obtained by one investor, the total amount of the issuance, the number of investors, the quality of targeted investors and the nature of transaction are the main criteria of qualifying an issuance as private.

[8] Capital Market Act Section 5(1) point 95, and Section 20(1).

ciation differs from its for-profit counterpart in that it does not aim to produce profit. Any profit made by the company cannot be distributed among its members, rather it must be retained within the company. A non-profit business association may not be transformed into for-profit organization.

As to the ownership structure of companies, three major characteristics are worth noting.

(i) Privatization was a key element of the economic and political changes in all former socialist countries.[9] The ideology of the socialist regime was that the economy should be governed directly by state organs, and, therefore, the state owned all property. When the socialist system collapsed and a market based economic system was introduced, the concept of overall state ownership was no longer sustainable. It was a precondition of an efficient market economy to have real owners, directly interested in the profitability of their property. To reach this goal two main questions had to be decided: in what form and to whom state property should be distributed. There were political forces proposing to return all state property to the original private owners or their successors. However, it turned out that returning property in this manner would be impossible for simple technical reasons: the most obvious problem was that properties were not in the same condition as they were when taken into state ownership. Furthermore, it would have been against economic rationality to physically divide economic units in order to distribute the parts to new (former) owners.

Only the churches had the right to have those buildings formerly used for their main activity returned, all other persons (or their successors) who were deprived of their land, houses or workshops by nationalization were compensated to a certain extent by issuing them with securities. These

[9] For the Hungarian privatization process see e.g. *Czuczai Jenő*: A magyar privatizáció alulnézetből. Múltja, jelene, jövője. Javaslat egy új liberális gazdaságpolitikának megfelelő privatizációs jogi, szervezeti-intézményi koncepcióra; Agrocent Kiadó, Budapest 1994. (Jenő Czuczai: Hungarian Privatization from bottom view. Past, Present, Future. A Proposal of the Legal, Organizational-Institutional Concept of Privatization for a New, Liberal Economic Politics;); *Mihályi Péter*: A magyar privatizáció krónikája 1989–1997; Közgazdasági és Jogi Könyvkiadó, Budapest 1998. (Péter Mihályi: The Chronicle of Hungarian Privatization 1989–1997); Sárközy Tamás: A privatizáció joga Magyarországon. Indulat nélküli elmélkedés tényekről, lehetőségekről; Unió Kiadó, Budapest 1991. (Tamás Sárközy: Privatization Law in Hungary. Emotion-free Meditation on Facts and Possibilities); Sárközy Tamás: A privatizáció jogi szabályozása Magyarországon 1988–2004. Állami Privatizációs és Vagyonkezelő Társaság, Budapest 2005. (Tamás Sárközy: Legal Regulation of Privatization in Hungary); Sárközy Tamás: A rendszerváltozás és a privatizáció joga. A tulajdonváltozás joga a volt szocialista országokban; Magyar Tudományos Akadémia, Budapest 1997. (Tamás Sárközy: The Law of Change of System and the Law of Privatization. The Law of Change of Ownership in Former Socialist Countries).

securities (called compensation coupons) could have been used as means of payment in privatization transactions or in the course of buying agricultural land or state owned apartments.

As it was decided that state owned properties would not be redistributed in kind, the next question was how these properties could be allotted. At this point companies and company law gained eminent importance. State enterprises were transformed into companies whose shares were transferable (i.e. limited liability companies and companies limited by shares). The majority of privatization was carried out by selling these shares in companies.[10] One could find it ironic that companies whose normal economic function was to concentrate capital or other factors of economic activity, at this stage of history served just the opposite purpose, namely distribution of property.

As a consequence of the privatization process, state ownership in companies has decreased remarkably. In general, the state has maintained its shareholding in companies with national importance, as the state wants to exercise its power not only as an external regulator but also as an owner with the right to make decisions in the company. Simple examples can be seen in the national railway company or the Hungarian Post. In 2007, a special act was enacted for state property,[11] which determines which companies shall be kept in permanent state ownership and to what extent.[12]

(ii) The second main feature of the ownership structure of companies is that the proportion of foreign investors is relatively high. This is a result of the method of privatization. State owned property was not distributed free of charge; the new owners had to pay real price. As a matter of fact this was a crucial element of establishing real ownership interest in distributed

---

[10] Foreign investors were active in Hungarian privatization. By the end of 1997 the majority of the energy sector, the processing industry, telecommunication and banking sector foreign owned. In the commercial branch of economy the proportion of the foreign investors was around 50 %. Source: Diczházi Bertalan: Tapasztalatok és tanulságok. Külföldi működőtőke-befektetések Magyarországon (Bertalan Diczházi: Experiences and Lessons. Foreign Working Capital Investments in Hungary); <www.hhrf.org/korunk/9811/11k27.htm> (website visited on 22 April 2010).

[11] 2007. évi CVI. törvény az állami vagyonról (Act No. CVI. of 2007 on State Property).

[12] The supplement of the Act lists less than fifty companies in different fields of economy. For example the state maintains its 100% ownership in a number of forestry companies, in some financial institutions, in certain energy companies, and in the Hungarian Railway Company. The state shall have more than 75% of voting power in regional water supply companies or in the Hungarian Post. A simple majority is prescribed for the Győr-Sopron-Ebenfurt Railway Company, in some companies operated by the Ministry of Defence. In two financial institutions, whose function is to help the export of Hungarian companies, the state keeps more than 25% of voting rights.

property. However, Hungarian citizens and new economic organizations did not have sufficient finances to buy all state property, therefore, foreign investors were allowed or even invited to participate in privatization. As the success of privatization depended on the willingness of foreign investors to invest in Hungary, any means of persuasion – including foreign-friendly legal regulation – was desirable. In this context economic reality influenced company law legislation.

(iii) The third noteworthy characteristic of the ownership structure of Hungarian companies is that the number of public companies is relatively small, and there are no big public companies with totally scattered shareholdings. Of course there are small investors, but in every Hungarian public company – including listed companies – a single shareholder or a group of shareholders who dominate the decisions of the company can be identified.[13] Given the deliberate targeting of international investment these dominant shareholders are quite frequently foreigners.

II. The Idea and Process of Codification

1. Short History of Contemporary Company Law Regulation

The history of modern Hungarian company law legislation goes back to the end of the eighties and produced three subsequent acts for business associations. In order to have a fair view of the development it is worth examining the driving forces behind every code, in what circumstances and for what reason they were enacted.

a) Companies Act 1988[14]

Contemporary company law started in 1988, when a new Companies Act was passed by the Hungarian Parliament. The timing is somewhat peculiar. At that time Hungary was still a socialist country with a single political party who had exclusive political power, also exercised over the state organs. The majority of the national wealth was owned by the state and operated in state enterprises. How could company law legislation written to be more or less consistent with commercial tradition fit into this economic and political system? In answering this question I would like to remind the reader that in the sixties a reform of economic management took place in Hungary. The former system under which state organs could

[13] Such a domination is not exclusively established by a majority of voting rights.

[14] 1988. évi VI. törvény a gazdasági társaságokról (Act No. VI. of 1988 on Business Associations).

influence the activity of economic organizations by direct orders was replaced by a more flexible one, in which the state did not give direct orders, only established the normative framework of the economy and introduced general incentives in order to make state enterprises and other economic organizations act in accordance with the economic plans fixed by the state. As a part of this new system, a very restricted market was acknowledged. Economic organizations had no further compulsory orders from the state; therefore, their economic relations had to be organized in another way. This alternative way was a market or the imitation of a market. However, a market needs independent owners who can enter into market transactions with each other. This was achieved by the introduction of rules which generally prohibited state enterprises from being deprived of property given to them in the course of foundation. In theory, the owner of the property was the state, and the state enterprise only managed the wealth entrusted to it, but in practice the owner could not exercise ownership rights. The independence of state enterprises was strengthened by organizational elements in the eighties. Directors of the state enterprises were not appointed by state organs any more, but were elected by the employees directly or through representatives.[15]

In spite of all these developments, the performance of the Hungarian economy was not satisfactory. It became general opinion, that the economic problems could be cured by enhancement and improvement of market relationships, while the basic elements of the socialist economic and political system were maintained. It was recognised that one of the greatest disadvantages of the socialist economic system lay in the efficient allocation of capital, and it turned out that this form of capital allocation, through direct state orders or by state determined incentives is impossible to implement in practice.

Formation of companies, however, is a flexible and efficient device for reallocating existing capital either in cash or in kind. Furthermore, it seemed to be a proper tool for attracting foreign capital into the country and encouraging citizens to increase private saving. Therefore, it was decided that this device should be applied to the socialist economic system. There were a number of important elements in the regulation. The new act allowed practically anybody to participate in companies, and to utilise his

---

[15] *Sárközy Tamás*: Vállalati önállóság, vállalatirányítás, társulások; Közgazdasági és Jogi Könyvkiadó, Budapest 1972. (Tamás Sárközy: Independence, Management and Co-operation of Enterprises), Sárközy Tamás: Egy gazdasági szervezeti reform sodrásában; Magvető Kiadó, Budapest 1986. (Tamás Sárközy: In the Streamline of an Economic Organizational Reform); *Prugberger Tamás*: Vállalati tulajdon, vállalati önigazgatás, polgári jogias munkajog; Gazdaság és Társadalom 1990/4. 75–99. (Tamás Prugberger: Ownership and Self-government of Enterprises, Employment Relationships Having Private Law Character).

or her capital for this purpose. Individuals, foreign natural and legal persons could become members in companies. In the beginning a majority shareholding owned by a foreigner required a state permission, but this restriction was quickly abolished. Taking into consideration that state owned property was combined with other forms of properties within a company, and that this company made up of combined property could participate in another company, the concept of uniform and exclusive state ownership could not survive. It was acknowledged that the owner of the capital provided by the members (shareholders) is the company itself.

This regulation – especially the rules concerning the ownership structure – was only compatible with the socialist system in theory or at the ideological level. In fact it defied the logic of the socialist economic system. In this sense the Companies Act was ahead of its time and was a remarkable component of those factors that led to the collapse of the regime. In this field the legislation did not follow the reality, rather, it created reality.

b) Companies Act 1997[16]

The first companies act was replaced by a new act in 1997. The former law was completely set aside and the new act regulating the whole field came into force. Such a broad legislative action within ten years could have been justified by a brand new concept of the company law legislation. But, in fact, there was no such a new concept behind the new act, rather a range of significant factors.

During the years the Companies Act 1988 had been in force, the rights provided by company law were frequently abused by company members, putting company creditors at a disadvantage. The most common abuse was that a company with limited liability for its members incurred debts shortly after its formation and before the creditors could have the chance to enforce their claims, the members – who normally acted also as directors – wound the company up, leaving the creditors' claims unpaid. As the company's assets did not cover the debts, the members of the company enjoyed limited liability, and directors were liable only to the company itself, the creditors had to bear the losses. In this period a great number of new companies were formed, and a relatively high proportion of them were used for unfair purposes. For these reasons, there was a social and political demand to draft stricter company law rules that could prevent abuses and provide guaranties for company creditors.

---

[16] 1997. évi CXLIV. törvény a gazdasági társaságokról (Act No. CXLIV. of 1997 on Business Associations).

Since the Companies Act 1988 was introduced without any immediate precedent, mistakes in its drafting were inevitable. These mistakes were discovered in the course of applying the law. It was a natural expectation to correct these mistakes. For example the first Companies Act provided that a member of a limited liability company can be excluded by a company resolution, however, the resolution could be challenged in court. This provision proved to be almost unenforceable. The decision-making rules for instance made it possible for members to mutually exclude each other, producing a situation that could hardly be solved. Another problem was that after a company resolution on exclusion, the company could sell the excluded member's share, and when the court established that the exclusion was unfounded, the member's rights could not be restored. Considering these problems, the Companies Act 1997 had a different approach to the question of exclusion. It was declared that the decision to exclude falls under the court's authority, and the company may only initiate such a decision.

The third argument for a new companies act was that Hungary and the European Community had entered into an agreement for Hungary to join the Community,[17] and this agreement imposed an extensive obligation of legal harmonisation on Hungary, including in the field of company law. The new act was intended to fulfil this task of harmonisation.

A frequent justification for the new legislation is the fact that other regulations related to company law legislation (e.g. capital market regulation, insolvency law, accounting law) were developed later then the first Companies Act, some changes were therefore also necessary in the field of company law to harmonise these laws with each other.[18] A further argument was that privatization had been almost completed by the middle of the nineties, consequently creating a new company system based on private property that needed new regulation.

---

[17] European Agreement concluded in Brussels, 16 December 1991 (Europe Agreement establishing an Association between the European Communities and their Member States and the Republic of Hungary of 16 December 1991).

[18] For Example the Companies Act 1988 did not make a difference between companies limited by shares issuing shares to the public or to a closed circle of investors. The shares had to be issued in printed form, and they could be bearer or registered shares upon the choice of the company. However, the development of securities law regulation went beyond these rules by the mid-nineties: it introduced dematerialized securities, prohibited the issuance of bearer shares and made sharp difference between public and private issuance of securities. These developments necessitated the adjustment of company law regulation.

c) Companies Act 2006[19]

Again, less than ten years had elapsed before a new companies act came into force. In this case, there were no serious attempts to create substantial arguments to explain the necessity for a completely new code. It was admitted by the head of the Codification Committee appointed by the Ministry of Justice for preparation of the new Companies Act, that the new act is no more than an extensive modification of the old one, and the new act is new in name only.[20] The explanation for creating a new act is overwhelmingly technical: the Companies Act is used not only by lawyers but also by investors, auditors and other laypersons, who could not manage an act which had been modified several times.[21] Though this argument is not accepted by all lawyers dealing with company law and codification, this idea has prevailed so far, and legislative organs followed this concept.

As to the merit of the modifications, there are no characteristic new directions. In my opinion two elements should be highlighted, both of them are classical transplants. The Hungarian company law legislation introduced regulation for wrongful trading[22] and for groups of companies.

2. Structure of Company Law Codification

a) Single Code

It was clear from the beginning of the modern company law legislative process that different types of business associations were to be regulated in a single company law statute rather than multiple codes. Legal traditions could have justified both solutions. Hungary had had a Commercial Code from 1875,[23] which regulated commercial companies, namely the business

---

[19] 2006. évi IV. törvény a gazdasági társaságokról (Act No. IV. of 2006 on Business Associations).

[20] Sárközy Tamás: A harmadik Gt. – a fontolva haladás törvénye (Tamás Sárközy: The third Companies Act – the act of pondering development); Gazdaság és Jog 2006/6–7. p. 3. In this article the author acknowledges that the Companies Act 1997 was also substantially only an amendment of the first act, whose concept and basic principles have not changed. (p. 4.)

[21] Sárközy (previous note), p. 4.

[22] Interestingly enough, this institution does not have Hungarian name. The expression "wrongful trading" is used in Hungarian. Fortunately the act itself does not name this institution, just describes the conditions under which a director of a company becomes liable towards creditors of the company instead of shareholders.

[23] 1875. évi XXXVII. törvény a Kereskedelmi Törvényről (Act No. XXXVII. of 1875 on Commercial Code). It worth noting that the company law rules of this code were not set aside until the Companies Act 1988. Though they were in force even after the World War II, the formation of new companies was not allowed on the basis of these rules. They were applied only to a few economic organizations that had been formed earlier and for some reasons kept their company form.

partnership, limited partnership,[24] companies limited by shares and co-operatives. The regulation of limited liability companies came some decades later, in 1930,[25] and remained separate act till 1988.

However, in contemporary company law legislation, different company forms are regulated in a single act, because their basic economic functions are the same. Accordingly, a series of common rules can be applied. It would have been unreasonable to repeat all these common rules in different laws separately for each and every form of business association. The Hungarian legislator decided to follow the classical form of a code with a set of general rules applied to all types of companies, with the special regulations for each provided in separate chapters of the code.

In Hungary a new Civil Code is being drafted. Although there was a proposal to include the regulation of business associations in the Civil Code,[26] it is likely that this proposal will not be accepted.

b) Regulatory Method: Mandatory or Enabling Regulation?

Unlike the question of single code or separate acts, the regulatory method of Companies Act is a subject of permanent discussion and the regulation itself has been already modified several times. The Companies Act 1988 was the most liberal in this respect, providing that the parties may generally deviate from the rules of the act except for cases where the deviation is expressly prohibited. As for companies limited by shares, the regulation scheme was just the opposite: deviation was generally prohibited excepting those norms which expressly allowed departure from the given norm.

This method of regulation led to ambiguities in the application of the law. There were attempts to abuse the enabling regulation and to deviate from the law even if it was obvious that the deviation was unacceptable. For example the norms defining company forms did not expressly prohibit deviations from positive law. But the courts had the opinion that a limited liability company cannot operate with unlimited liability for members, as this would be contrary to the concept of a limited liability company. Consequently it was declared by the courts that parties are not entitled to deviate from the legal definitions of the act, irrespective of whether the act contained a prohibition. A similar solution was reached in the case of minimum capital requirements, where the act failed to insert a rule stating that the deviation from this regulation was not allowed. Some founders of

---

[24] As explained earlier, in English a partnership cannot be qualified as a company, but in Hungarian "company" is a collective term that includes different types of organizations, some of them known in English as partnership.

[25] 1930. évi V. tc. a korlátolt felelősségű társaságról és a csendestársaságról (Act No. V. of 1930. on Limited Liability Companies and Silent Partnerships).

[26] As it is for example in the Netherlands or Italian Civil Code.

companies argued that the companies can be formed with lower amount of capital than prescribed in the act, because there was no prohibition against it. The courts did not accept this argument and treated minimum capital requirements as mandatory rules.

The second Companies Act has changed the approach to the question of regulatory method. It stated that the rules of the act are generally mandatory and the deviation is allowed when the act itself expressly states. The reasoning for this change was that this method could eliminate all the problems resulting from the loose enabling regulation. At the same time the theoretical argument for institutional approach of company law was strengthening. It was argued that companies are more than simple contractual relationships between the participants in company law relationships. Therefore, it was not acceptable to expect the same freedom in shaping these relationships as in pure contractual relationships. Freedom of contract cannot be a governing idea in legal relationships whose influence reaches beyond the parties themselves. In order to protect society, the state had to intervene in company relationships, and the protective nature of the regulation necessitated a mandatory character.[27]

While mandatory regulation actually did resolve the above problems, it generated new questions. Companies are different in their activity, ownership structure, economic goals, and in many other factors. Legal regulation cannot adequately manage this level of diversity, and mandatory regulation deprived the parties of the possibility to construct their company according to their needs. This rigidity hindered the formation and effective activity of companies, and enhanced the risk to the members, as they were forced to regulate their special relationships in a shareholders' agreement whose enforcement was highly questionable.

The turn to mandatory regulation raised the question of how to handle those relationships not regulated in the law. It was argued that under a mandatory regulation, the lack of a specific rule meant that the parties were not entitled to fill this gap and develop a rule on their own. The logical consequence of this position would have been that only the rules of the Companies Act could be applied: no more and no less. Fortunately the third Companies Act (of 2006) closed the discussion on this matter by regulating the question. Now it is stated in the law that the parties may

---

[27] Sárközy Tamás: Bevezető tanulmány „A társasági és a cégtörvény kommentárja" című kötethez; in: Sárközy Tamás (szerk.): A társasági és a cégtörvény kommentárja; HVG-Orac, Budapest 2002. I. kötet, 39–52. oldal [Tamás Sárközy: Introduction to the Commentary of Companies Act and Companies' Registration Act. in: Tamás Sárközy (ed.): Commentary of Companies Act and Companies' Registration Act; Vol. I. page 39–52.].

freely agree on any issue which is not regulated by the Act.[28] However, the legislator was still anxious about this high degree of freedom, and tried to retain some level of control over the parties' agreement by providing that such an agreement is acceptable only if it is not against generally accepted company law policy, the aims of the regulation and the requirement to act in good faith.

3. The Role of Comparative Law in Codification

The Hungarian legislator knowingly used the method of comparative law in the course of codification. The aim of codification was to produce a company law compatible with other company law regimes, reflecting the newest achievements of company law legislation, and therefore more easily acceptable for foreign investors. These goals could only be reached by studying foreign company laws, their development, and directions of changes.

When the codification process started, the Codification Committee charged leading Hungarian scholars with the task of compiling studies on the company laws of different European countries and those of the USA in order to identify the core problems of company law, and the contemporary solutions to these problems.[29]

This comparative study was never intended to choose a single foreign legal system as an exclusive model for Hungarian company law legislation, and it was also out of the question that a foreign act could be taken over as a whole. However, it should be stated that one model was in fact used in the codification, not a foreign law, but rather the former Hungarian company law legislation. There was a clear intent to adopt as many elements from the Commercial Code (1875) and of the Limited Liability Company Act (1930) as possible. Thus, the first Companies Act was, to a significant extent, a historical legal transplant.

This could be important from the point of view of contemporary legislation because the historical Hungarian regulation was strongly influenced by German and Austrian law. So, by using the old Hungarian legislation, the legislators indirectly had these foreign laws as models for the regulation. It also follows from this fact that the comparative studies connected with company law codification concentrated on German and Austrian law.[30] It was valuable to examine these company law systems in detail be-

---

[28] Companies Act 2006, Section 9(1).

[29] These studies were used in the codification work, but remained unpublished.

[30] A good summary of comparative legal studies connected with German law was: Sárközy Tamás: A magyar társasági jog Európában. A társasági és konszernjog elméleti alapjai; HVG-Orac, Budapest 2001. (Tamás Sárközy: Hungarian Company Law in Europe. Theoretical basis of company law and the law of group of companies).

cause the developments of the previous decades were missing from the old Hungarian legislation, due to the fact, as discussed above, that company law regulations were not living and applicable laws. The deficiencies could be more easily identified and remedied by studying laws with common cores to the Hungarian law than by examining other regulations.[31] However, the British and American company law were not neglected, and some elements of these laws compatible with the Hungarian law based on the German and Austrian model were introduced into the company law.

4. Influence of EC Law

As mentioned earlier, Hungary has assumed the obligation of harmonising its legal system – including company law – with the law of the European Communities in the European Agreement. But Hungarian company law regulation took EC law into consideration even before this became a legal obligation. The intention to meet European requirements was already a consideration for the first Companies Act, though it was not an expectation, as at that time joining the EC was only a dream for Hungary. But EC law was a good indicator of current company law problems and showed key solutions as well. Looking at the EC company law, one could presume that the identification of regulated subject matters and the accepted solutions had been based on an extensive and thorough legal comparison, and the EC law reflected the best solutions. Furthermore, the function of EC laws is to harmonise the laws of member states. Presuming that this function has been fulfilled, a comparative study of each member state did not have to be undertaken, it was enough to examine EC law, as it could be assumed that the company laws of member states followed the prescriptions of community law.

Implementation of EC law, however, was not a simple exercise and the results of harmonisation were not positive in every case. It was obvious that the company structure in Hungary is not the same as in Germany, France or Great Britain. Was it feasible or even possible to introduce the same sophisticated solutions in Hungary, as used in more developed countries? The answer was not always in the affirmative. In addition, it was not only the company structure but also the company law that was less developed in Hungary than in the EC member states. Therefore implementation of EC law made national company law uneven. As is well known, EU company law regulation does not constitute a comprehensive and overarching company law system. The regulation is fragmented; it deals with problems separately without organizing these elements into an independ-

[31] See e.g. Molnár Gábor Lajos: Bevezetés az angol társasági jogba; Books in Print, Budapest 2002. (Gábor Lajos Molnár: Introduction to English Company Law).

ent, general set of rules. Implementing these fragmented rules into different national legal systems will almost inevitably provide different results. Furthermore, the differences may appear, not only between the laws of member states, but also within the company law legislation of a single country. The national legal regime cannot always adopt foreign rules smoothly, and without any difficulty. The danger of an uneven result is greater when – as in the case of Hungary – the rules to be adopted were fixed without any possible influence from the country seeking to apply it, when the rules were determined by other countries, whose legal system and legal traditions are necessarily different from the new member states.

As a consequence of this contradiction, some elements of the regulation coming from EC law were unnecessarily detailed and inadequate for the Hungarian company structure. At the beginning Hungary could not benefit from the sophisticated EC regulation. In many cases, for example, Hungary introduced the general rules required by EC, but did not implement exceptional rules that were allowed, as it did not want to jeopardize EC acceptance of the national legislation.[32]

In my view the most striking proof of our difficulties in handling EC law was that in the case of the second company law directive (Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, O.J. L 26/1 of 31 January 1977). Hungary incorrectly determined the company forms to which the directive should be applied. The problem was that we did not make difference between public and private companies limited by shares. As a result Hungary had to extend the regime for guarantees (e.g. minimum capital requirements) designed for public companies to private companies as well. This mistake could have been corrected by modification of the directive.[33]

---

[32] On harmonization of Hungarian company law to the law of EU see András Kisfaludi: Harmonisierung im Recht der Handelsgesellschaften; in: Lajos Vékás – Marian Paschke (ed.): Europäisches Recht im ungarischen Privat- und Wirtschaftsrecht; LIT Verlag, Münster 2004. pp. 85–267.

[33] Directive 2006/68/EC of the European Parliament and of the Council of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital, O.J. L 264/32 of 25 September 2006.

III. Specific Company Law Issues

1. Corporate Governance Code

As it is well known, corporate governance codes are prepared, maintained, and applied by different organizations or persons, in different ways. In Hungary it was the Budapest Stock Exchange (BSE) which expressed an interest in drafting a corporate governance code. To prepare the draft, the stock exchange set up a committee made up of government officials, scholars from the field of economics and law, representatives of issuers and the BSE. The first version was approved by the Board of Directors of the BSE in 2004. The committee still exists and from time to time discusses the developments in corporate governance issues. The Code itself has already been modified, with the second version passed in 2008.[34]

It follows from the organizational background that the Corporate Governance Code is only applied to public companies limited by shares listed on BSE. The norms of the Code are not legally binding rules; they are not approved by any legislative authority, so they operate on a "comply or explain" basis.

However, the Companies Act 2006 acknowledged the BSE's Corporate Governance Code by inserting a rule into the Act[35] providing that public companies limited by shares are obliged to prepare an annual report on corporate governance. The proposal of the report is to be submitted by the board of directors to the ordinary general assembly together with the annual financial report, and the general assembly must decide whether or not to approve the report. If the company has a supervisory board, the board of directors may submit the proposal to the general assembly with the consent of the supervisory board.

The report must describe the company's corporate governance practice in last year, and declare which rules of the Code the company deviated from in the course of applying the Corporate Governance Code issued by BSE. Although the Companies Act does not require that the deviation be explained (strictly reading, the mere declaration of deviation would be enough), the Corporate Governance Code itself imposes this obligation on issuers, therefore this element of the report must also be included. According to the Companies Act, the Corporate Governance Report has to be published on the company's website.

---

[34] The official name of the Corporate Governance Code is „Corporate Governance Recommendations". On 12 March 2009 the document is available at the website of BSE: <www.bse.hu/data/cms61401/CGR080516.doc>.

[35] Companies Act 2006, Section 312.

As to the contents of recommendations and rules included into the Corporate Governance Code, it is worth noting that they do not go much further than the general principles of private law and company law. In many cases the code simply repeats the legal regulations. However, in some areas it also contradicts to the Companies Act.

In my opinion the weakness of the Code can be explained to a great extent by the fact that BSE is a very small stock exchange, therefore, it is very much dependant on good will of issuers. If just a few issuing companies left BSE, it would make it highly vulnerable; therefore BSE has to maintain good relationship with issuers, which in turn prevents BSE from acting as an effective regulatory body.

2. Directors – Shareholders Relationship

The legal regulation of the relationship between directors and shareholders touches basic policy questions. The ultimate purpose of the company must be determined, and – accordingly – the nature of the directors' services. This includes considering whether they are simply servants of the shareholders, and bound to perform the shareholders' will, or if they are expected to take other interests into consideration as well. The Hungarian Companies Act provides that the management of the company is a duty for directors, who are obliged to fulfil their obligation giving primary consideration to the best interests of the company. That means that the director is subordinated neither to individual shareholders nor to the complete body of shareholders, but rather to the company as a whole. As the company is an incorporated legal person, distinct from its members, directors are independent in their management activities. They should observe only the laws, the founding documents of the company (articles of association) and the resolutions of the shareholders' meeting. The shareholders may not give direct orders to the directors (except for one man companies), and the directors may not be deprived of their decision making power except where the law or the articles of association so provide.[36]

This independent power to manage the company is coupled with a liability to the company. If the director breaches his/her obligation to manage the company in the best interest of the company, then the company itself may claim damages. Such claims are examined under the conditions of general tort law, which means that a director could only be held liable if his/her act or omission was unlawful, caused damages to the company, and if the director's behaviour was responsible for the damage. In connection with the last condition, the burden of proof falls on the director. If other conditions are present, then the director can exempt him/herself from

[36] Companies Act 2006, Section 22(3)–(5).

liability if he/she can prove that in order to avoid the occurrence of damage he/she acted as could be generally expected from any person in the same position.[37]

There are not too many court cases on directors' liability, but still it is obvious that pursuing a business activity is always risky, consequently it is an inherent part of normal business to suffer loss. If directors could be held liable for this loss, then liability could not fulfil its function, and reasonable persons would not accept a nomination for directorship. Business decisions based on reasonable deliberation, analysis of risks and benefits and consideration of all relevant circumstances do not usually incur liability, as this is generally expected from any person in the position of a director.

As already mentioned, the current Companies Act – based on the English model – introduced a regulation on wrongful trading.[38] According to this rule, in the case of danger of insolvency, the directors should manage the company, not in the company's best interest, but rather giving priority to the interests of creditors. If they breach this obligation and the company is wound up, creditors may request the court to declare the director liable for unpaid debts, and after completion of the liquidation procedure, creditors may in fact claim payment.

The loyalty of directors towards the company is supported by further rules related to the multiple directorships and obtaining shareholdings in other companies. There is no limitation on the number of positions one person may hold,[39] but the director must notify the companies where he/she serves as a director when elected as a director at a new company.[40] A director may not become director and shall not obtain shareholding in another business association, if the main activities of the two companies are the same. Acquisition of a shareholding on undertaking directorship in a public company limited by shares differs slightly, the articles of association and the company's resolution may exempt the director from this prohibition.[41]

In order to avoid exploitation of company's business opportunities, it is generally forbidden for directors and their close relatives to conduct the same business as the company does.[42]

---

[37] Companies Act 2006, Section 30(2).

[38] Companies Act 2006, Section 30(3).

[39] At an earlier stage of company law legislation there was a rule saying that one person may be director at a maximum of three companies at any one time.

[40] Companies Act 2006, Section 24(3).

[41] Companies Act 2006, Section 25(1).

[42] Companies Act 2006, Section 25(2).

3. Rights and Remedies for Shareholders

The rights of company members are different in different types of companies. Focusing on companies limited by shares – where due to the great number of shareholders, and the relatively small value of one investment unit, the realisation of shareholders' rights is the most difficult – one could differentiate between organizational and financial rights.

The main organizational rights include:

- The right to participate in the shareholders' meeting either personally or by using electronic devices.[43]
- The right to speak and make proposals at the shareholders' meeting.
- Voting right: generally the number of votes is proportional to the shareholder's capital contribution.[44] However, the company may issue preferential shares that provide multiple voting rights up to a multiple of ten.[45] Another type of preferential share provides the right to elect a maximum of one third of the members of the board of directors or the supervisory board.[46] Only private companies limited by shares can issue these preferential shares. In public companies limited by shares, the number of votes that can be cast by a single shareholder or a group of shareholders (the criteria of a group shall be determined by the articles of association) can be limited by the articles of association.[47]
- Right to information. The shareholders are entitled to information connected with issues on the agenda of the shareholders' meeting. Directors may refuse to provide information if the requested information qualifies as a business secret. In public companies limited by shares shareholders may decide that the board of directors has to disclose a piece of information even if it is business secret.[48]

The most important financial rights include:

- Right to dividends. Shares providing preferential dividends might be issued upon a decision of the shareholders. Dividends shall be paid only if the company has profit or freely distributable reserves, and if the shareholders' meeting – upon a proposal from the board of directors – decides to distribute the profit.[49]

---

[43] Companies Act 2006, Section 214.
[44] Companies Act 2006, Section 216.
[45] Companies Act 2006, Section 188.
[46] Companies Act 2006, Section 189.
[47] Companies Act 2006, Section 299.
[48] Companies Act 2006, Sections 215, 298.
[49] Companies Act 2006, Section 220.

- Right to the distributable property in the case of liquidation of the company.[50] Preferential shares might be issued in connection with this right as well.
- If the company issues special shares providing a right to interest on the nominal value of the share, the interest must be paid if the company has an annual profit with a distributable reserve.[51]

The above rights can be exercised individually, but there are some minority rights that are exercisable only by shareholders who individually or collectively have at least five percent of voting rights.[52] These minority rights are as follows:

- The minority has the right to ask the board of directors to convoke the shareholders' meeting. If the board fails to do so, the minority shareholders may request the court where the company is registered to convoke the meeting or to authorise the shareholders to do it.
- The minority shareholders may ask the court where the company is registered to order an independent audit of the annual financial report or of any business transaction within two years of transaction being completed, if the proposal to start such an examination was refused in the shareholders' meeting.
- The minority has right to bring a derivative action if the shareholders' meeting refused the proposal to claim damages from a shareholder, a director, a member of the supervisory board or the auditor.
- Minority shareholders may ask the board of directors to add some further points to the agenda of a shareholders' meeting that has been already convoked. In a public company limited by shares this right can be exercised by a one percent minority – as opposed to the general rule under which the minority right can be exercised by a five percent minority.[53] This lower limit is justified by the fact that in a real public company, the shareholdings could be very scattered, therefore it is much more difficult to concentrate the necessary number of votes to make up a minority group.
- Minority shareholders may request the court where the company is registered to order an audit to establish whether certain payments made to the shareholders met legal preconditions. In public companies limited by shares the size of the minority in this respect is one percent of votes.[54]

---

[50] Companies Act 2006, Section 278.
[51] Companies Act 2006, Section 192.
[52] Companies Act 2006, Section 49.
[53] Companies Act 2006, Sections 217, 300.
[54] Companies Act 2006, Sections 222, 300.

4. Company Law and Capital Market Law

In Hungary, capital market law has been changed at least as frequently as company law. The current regulation is the act No. CXX. on the Capital Market. The linkage between the Companies Act and Capital Market Act is the strongest for companies limited by shares. However, other types of companies could also be subject to capital market regulation as may any other economic organization.

From the point of view of companies limited by shares, the most important rules of the Capital Market Act are the provisions relating to:

- Creating and issuing securities,
- Disclosure requirements,
- Take-over bids,
- Transfer of dematerialized shares,
- Nominations.

The interrelationship between the two acts is especially close for the formation of companies limited by shares or the increasing of share capital.

IV. Nature and Function of Legal Transplants

1. Notion and Some Historical Elements of Legal Transplants

To understand the role of legal transplants in the development of a country's legal system or a certain area of law, one should have a clear understanding of the notion of transplant and the problems arising from the application of these tools in law making. There is a special contradiction behind of the notion of legal transplants. On the one hand, legislation belongs to exclusive authority of a sovereign state – regardless which kind of state (whether a feudalistic kingdom or a democratic parliamentary system). On the other hand however, problems and social conflicts that need legal solutions could be quite similar in different countries or jurisdictions. Does it follow from the concept of sovereignty that legal solutions for identical or similar economic or social problems should not be identical or similar? Would such similarities jeopardise the sovereignty of the state, and would it therefore be advisable to avoid them? I do not think so, and the facts do not support such a presumption. It is common knowledge that different legal systems may apply the same legal institutions and regulations. But identical legal solutions are not necessarily products of legal transplants. Autonomous, independent developments may produce the same outcome in a natural way without having any knowledge about the law of

other countries.[55] The fact that capital punishment, for instance, was frequently applied throughout the world and throughout history as a part of the criminal law system, does not mean that we should postulate that a single country "invented" this legal institution and all the other countries who introduced this type of punishment should be deemed as having transplanted this foreign institution into their legal system. It is more likely that different countries independently, as a result of natural developments came to the conclusion that punishment by death was an efficient mechanism for protecting society. It follows from this argument that the mere identity of a legal institution with elements stemming from other legal systems does not prove the presence of legal transplants.

However, the possibility of parallel and independent development of national legal systems does not exclude another way of introducing changes. From quite early in history countries have been taking over the legal regime of another nation. In most cases this development was coupled with political changes: when a country was annexed to another state either by peaceful, or by violent means, the law of the other country or a part of it was frequently introduced in the newly acquired territories.[56] The forced application of a foreign legal system can also be a device of political oppression.[57] In such historical cases, the application of legal transplants could be a highly sensitive issue, in spite of the fact that in certain situations transplants do have a positive influence.[58]

The adoption of foreign legal rules or institutions is not necessarily a matter of direct or indirect coercion. In recent times, with co-operation between independent states developing into a normal and more or less expected behaviour, becoming familiar with and taking over some elements of foreign laws has become a rational development for different reasons. One reason is that a newly emerging relationship often gives rise to conflicts for which there may not yet be a legal solution in the given system – simply due to the novelty of the problem – and the need for legal regulation could be met more easily by introducing rules that are applied in other countries, where similar problems have already occurred, than by elaborating a genuinely national solution.

---

[55] Alan Watson in his book comes to the conclusion that most legal developments are driven by transplants. Watson: Legal Transplants: An Approach to Comparative Law; 2nd ed. Athens, Ga./London, 1993.

[56] For example the Roman Empire, where Roman law was applied in the provinces.

[57] For instance as a part of retaliation after the suppression of the Hungarian Revolution and war of independence in 1848–49 the Austrian law was introduced in Hungary.

[58] It is well known fact from history that to a certain extent, colonization contributed to the development of the colonized territories, and a part of this contribution was the introduction of the legal system of the colonist.

Another reason for the implementation of foreign legal rules or institutions into a national legal system could be the demand for the harmonisation of laws. Differences between legal regimes can hinder international trade and other forms of co-operation among citizens and organizations of different countries. When this co-operation became a precondition of economic and social development, states started to work together on harmonising their laws, and removing legal barriers to co-operation. In many cases harmonisation of laws does not mean that new laws were not developed, but focuses instead on the adoption of rules from another national legal system. In this way harmonization can also be a vehicle for voluntary transplantation of legal solutions from one legal system into another. Legal harmonisation can be carried out through different methods. Bilateral or multilateral international treaties – concluded either on an ad hoc basis, or in an organizational framework – could be treated as traditional methods of harmonisation, where the voluntary character of acceptance of common legal solutions is obvious, as the states are the contracting parties. However, in the second half of the 20th century, new international organizations emerged whose member states are expected to harmonise their laws with rules established by the organization, or to apply these rules directly, as a part of the national legal system. For these organizations, membership itself carries the obligation to accept common rules, making harmonisation appear to lack a voluntary nature. But taking into consideration that becoming a member of such an international organization is always a free decision of a sovereign state, the legal harmonisation following from this decision is also a freely accepted obligation.

Another relatively new method of harmonisation is through the proposals, recommendations, and model rules for regulation that may be considered for implementation, prepared by organizations, ad hoc groups of scholars or other experts. There is no legal obligation – either directly or through an organization – to accept or even to deal with these international instruments, however, the persuasiveness of the proposals and the self-interest of the states to join the mainstream of legal developments can make them efficient tools of harmonisation.

So far we have spoken about legal transplants as legal institutions, concepts, rules and solutions imported from an existing foreign legal system. But the developments of recent decades in Central and Eastern Europe showed that ready-made solutions can be borrowed not only from contemporary legal systems but also from the past. During the 1980s and the 1990s there were basic political, economic and social changes in transitional countries resulting in a system completely different from the earlier one, i.e. from the socialist system to one of a market economy. From the perspective of private law regulation, the changes were dramatic. Instead

of an economic regime based on almost exclusive state ownership, and centrally planned, organized and governed economic activities, the former socialist countries aimed for a market based economy with autonomous and self-interested owners, who act freely in the market, where free competition prevails. It is clear that these vastly differing economic systems could not be regulated by the same legal infrastructure. There was an obvious demand for new legislation that could provide efficient tools for handling a market-economy system. It was also clear that new law should cover a fairly broad area of economic relationship, including not only private law elements, but also public law rules for organizing and controlling the market. For many countries it was almost impossible to instantly produce brand new legal regulation on this matter. This is the usual situation that gives rise to the implementation of legal transplants. In some countries, however, the need for legal regulation compatible with a market economy system was fulfilled, not by taking over a contemporary foreign law, but by revitalizing the old law of the country, which had not been actively applied for several decades. Reactivation of the law of a former era could take place either by formal enactment of an earlier legislative act or by formally introducing new acts whose content had been taken over from the former law. In my opinion these legislative methods follow the same patterns, fulfil the same functions and have more or less the same problems as accepting transplants from a foreign legal system, therefore, they can be referred to as *historical legal transplants*, and assessed together with transplants in general sense.

A further possibility to broaden the concept of legal transplants emerges if one does not postulate law exclusively as a product of state legislation. At a high level of generality, there may be some justification for the inclusion of terms and conditions elaborated and applied by autonomous individuals or organizations in their private contractual relationships, into the notion of law alongside acts and other normative regulations formulated by legislative bodies of the state. These terms have legal force through the acknowledgment of the binding force of contracts, and in this way they become a part of law. It is worth noting that transplants may have their roots not only in state laws but also in these contractual regulations. If contracting parties generally and frequently apply a certain legal solution based on a foreign rule in their contracts, then this solution becomes a part of the domestic legal system as well, and it can be qualified as a legal transplant.

2. Advantages and Dangers of Legal Transplants

Using legal transplants as legislative method has several obvious advantages, but they can also cause harm if their application happens without the

necessary care. To assist in making a balanced decision as to whether legal transplants are desirable and useful, we should list the pros and cons of transplants to get a true picture of this phenomenon. Considering the possible drawbacks along with the advantages can allow us to achieve a more sophisticated and efficient application of legal transplants. The advantageous features include:

Fast – Taking over ready-made legal rules and transplanting them into the domestic legal system is first of all a quick solution. It can shorten the time needed for preparatory work remarkably. This could be a decisive factor when political, economic and social relationships change quickly, and regulation cannot follow these changes through the normal process of legislation.

Cheap – In a narrow sense, using transplants can cut the costs of developing legislation, because fewer human resources are needed. In a broader economic sense all the other advantages of transplants carry a certain economic advantage which also makes legislation cheaper.

Good quality – If a national legislator resorts to the application of legal transplants, it could be a signal that they could not complete the legislative task to a sufficient standard by their own efforts. The reason for this is partly subjective and partly objective, i.e. it is due to the inherent nature of the legislation. Considering the tremendous demand for legislation in Central and Eastern Europe at that time of great political and economic changes, it is not surprising that the countries in the region did not have enough experts who were able to quickly produce legislation on those matters needing regulation. The lack of expertise can be resolved by using legal transplants.

But even if a country has sufficient expertise, legislation always has the problem, that field experiments are not possible. There are no laboratories where new laws can be tested before introducing them. However, when taking over existing and operating legal rules, institutions, solutions, then there may be sufficient information available regarding their application in their original environment, and from this data some conclusions may be drawn as to the possible impacts in the new environment. Though such extrapolation always involves some ambiguity, the possible impact of an operating legal rule can be better estimated than that of an unprecedented rule.

Internationally accepted – If we do not consider the case of historical legal transplants, then a great advantage could be that the new rule implemented into the national legal system will be familiar to lawyers from other jurisdictions from the beginning. At least the country of origin will feel comfortable about the new legislation, but if the original regulation is internationally known and accepted, then the new legislation will enjoy the benefits of this, with minimal effort.

Attractive for investors – One of the greatest contradictions in Central and Eastern European countries was that the citizens and domestic economic organizations lacked sufficient capital to purchase previously state owned property being made available through privatisation. Therefore, attracting foreign investors became a crucial element of successful privatization – especially in those counties where (like in Hungary) proposals for free distribution of national property were rejected. I do not claim that the legal infrastructure was the decisive factor for foreign investors in making investment decisions. But it can be maintained that it was an important element, and the more familiar the legal system was for those foreign investors, the more comfortable they felt themselves, and the more easily they invested their capital in those countries where legal regulation was similar to their original system. Legal transplants provided the simplest way to fulfil investors' expectations.

All these advantages of legal transplants cannot eliminate their serious dangers. These dangers are concentrated around two questions: firstly, whether or not the legislation is needed at all, and secondly, whether the transplanted regulation fits into the recipient legal system.

a) Need for regulation by transplants

History has shown that legislation is not an arbitrary activity: normally it is a reaction to social conflicts whose solution necessitates the intervention of the state. Legal rules are basically reflections of reality. In the case of judge-made law this is quite obvious: the rules are established as solutions to real individual legal disputes, therefore, there is no rule without real dispute. If the law is made not by the courts but by a legislative organ (either one person or a legislative body), the situation should be more or less similar. Generally, it is very unlikely that the legislator will elaborate legal rules for non-existing conflicts. To take a trivial example: if there were no theft in a society, there would be no legal regulation and punishment for it. And taking the opposite view: having legal regulation for theft is an unmistakable sign that the crime exists. The natural connection between social reality and its legal regulation might be broken by the application of legal transplants, especially when foreign legal rules or institutions are taken over as a complete package. When, for instance, a complete foreign code is transplanted into a national legal system, some elements of the regulation may be unnecessary, because the situation in the recipient country differs from the situation in the country of origin, and therefore, the need for regulation is also different. A regulation necessary in one country is not always necessary in another one. The danger of superfluous regulation is even bigger when not a single code but a whole legal system

is transplanted into a national system; particularly as it carries a mandatory character. That was the situation when Hungary started its accession process to the European Union. There were some EU norms that had to be adopted even though they had no real sense in the legal environment of the recipient country, due to the different nature of the social relationships to be regulated.

One might say that legal rules without function do not cause harm either, because they are not applied. With regard to prohibitive norms this may be true, but in the case of legal norms prescribing positive obligations, the consequences are different: these laws must be obeyed and this increases costs for those the norm applies to, and indirectly to the whole society.

b) Adequacy of regulation by transplants

Even if the circumstances demand legal regulation for a given conflict, it is not certain that a legal institution transplanted from a foreign legal system could adequately meet this demand. A legal rule has its effect in interaction with its environment. If the circumstances change, the effects of the rule change as well. It is almost inevitable that a transplanted rule will meet different conditions in the new environment; consequently its effects are not necessarily the same as in the original situation. A rule applied efficiently in a certain situation can easily become ineffective or even detrimental having been transplanted into another legal system. Therefore, using legal transplants should not be a mechanical activity, but rather given special consideration and analysis as to how the changing circumstances will influence the effect of the transplant.

As an illustration I refer to the regulation of employees' participation in company management. Remembering that the codification of modern Hungarian company law started under the socialist regime, there was an expectation that employees of companies would retain the rights they had held in state owned enterprise also in the newly structured companies. It was a lucky coincidence, that employees' participation was not a totally unknown phenomenon in capitalist companies. The Hungarian legislator took the German codetermination system as a model, and introduced a regulation, under which the employees of the company have the right to send their representatives to the supervisory board if the number of employees exceeds 200. One factor, however, was overlooked (whether intentionally or due to lack of understanding, cannot be determined), namely the different functions of supervisory boards in German and Hungarian company law legislation. Under German law the supervisory board has strong decision-making power, including the ability to elect the directors. Hungarian legislation has construed the supervisory board in a different

way: solely as a supervisory body without decision-making power.[59] As a consequence, the employees of the German and Hungarian companies have the same right, but in fact the same right of participation in supervisory board is completely different due to the fact that the supervisory board itself differs in the two legal systems.

[59] It is true that the members of the company may provide in the Articles of Association that supervisory board has the power to elect and withdraw directors, and make a decision upon directors' remuneration, but the default rules do not vest such a power in the supervisory board.

Company Law in Poland: Between Autonomous Development and Legal Transplants

KRZYSZTOF OPLUSTIL and ARKADIUSZ RADWAN

I. Introduction

1. Polish Law in Continuous Transformation

At the turn of the 1980s and 1990s Polish business law was at a point where it was burdened with a fifty-year long gap in development as well as the distortions inherent to a centrally planned economy. This heritage therefore included a lack of any case law, minimal domestic experiences with business law practice and a weak contemporary legal doctrine. Not surprisingly, the special circumstances of this "new opening" leaned in favour of quick solutions – an urgent need emerged to search for practical solutions to the daily problems of commercial dealings.[1] The growing demand created a gap on the market large enough to accommodate nearly any offer. This undiscriminating market accepted any product regardless of conceptual quality. The resultant law and legal scholarship were an outcome of several factors: (1) voluntary (legal transplants) or mandatory (implementation of the *acquis communautaire*) import of foreign legal institutions, (2) reanimation and revitalization of pre-war concepts,[2] (3) patterns of legal services and legal know-how brought along with the expansion of foreign law firms into Poland, or domestic firms modelled on

[1] See Radwan, A., *Non ex regula ius sumatur or about a few endangered truths*, Quarterly for the Entire Commercial, Insolvency and Capital Market Law (HUK) 2007, No. 1, p. 3.

[2] Not only in Poland but also in many other countries, e.g. in Czech Republic the very first available literature were reprints of pre-war commentaries and handbooks, see Radwan, A., *25 thoughts on European Company Law in the EU of 25*, European Business Law Review (EBLR) 2006, No. 4, p. 1171 and note No. 11.

Anglo-Saxon law offices,[3] (4) a search for quick solutions to emerging problems of everyday legal practice, and (5) autonomous, and sometimes light-hearted writing in the rediscovered field of business law, which consequently became a part of the academic curriculum and required supplementation with new content.[4]

This paper reviews company law development in Poland over the last twenty years as seen in the context of overall economy transformation and corresponding developments in foreign legal systems. The latter are mentioned predominantly in connection with their impact on Polish law. In order to more conveniently convey the patterns of legal development, a brief outline of the governance structure of a Polish company is provided in this paper. Special attention is paid to the impact of the *acquis* on a rapid transformation before Poland's accession to the EU peaking with the enactment of a new Code of Commercial Companies (CCC 2000) of 15 September 2000.[5]

2. The Course of Analysis

The analysis takes the following course. First the overall legal framework of Polish company law with references to the relevant provisions of the capital market law will be discussed in Chapter II. Then, in Chapter III we will turn to a more detailed analysis of the economic context of the corporate governance system in Poland including ownership structures and other relevant market conditions under which the laws and self-regulations have developed. Chapter IV shall examine the influence European Law has exerted on the development of Polish company law. Chapter V is designed to extend the analysis of exogenous input so as to discuss foreign sources of inspiration and provide case-studies of successful and unsuccessful legal transplants. In the further course of this analysis a detailed structure of the two types of capital companies in Poland will be delivered (Chapter VI)

---

[3] See Sołtysiński, S. *Complying with EU Corporate Standards: A Practitioner's View from Poland* [in:] Bermann, G.A./Pistor, K. *Law and Governance in an Enlarged European Union*, Hart Publishing, Oxford and Portland, Oregon 2004, p. 289; Stroiński, R. *Zasady dobrych praktyk w spółkach publicznych notowanych na Giełdzie Papierów Wartościowych – wybrane zagadnienia na tle prawnoporównawczym* [in:] Cejmer, M./ Napierała, J./Sójka T. (eds.), *Europejskie prawo spółek*, Volume III, *Corporate Governance*, Wolters Kluwer, Kraków 2006, pp. 79–81.

[4] See Radwan (*supra* note 1), p. 6–7.

[5] On the history of the Code and the general regulatory landscape see Sołtysiński (*supra* note 3), p. 297; Sołtysiński, S. *Reform of Polish Company Law* [in:] Grossfeld B., et al. *Festschrift für Wolfgang Fikentscher zum 70. Geburtstag*, Mohr Siebeck, Tübingen 1998, et pp. 419; Radwan A./Kołacz, J. *Legal history, foreign inspirations and recent developments in Polish company law* [in:] *Company Law and Corporate Governance in the Enlarged Europe – Central and East European Perspective* (forthcoming).

with particular emphasis on the duties of directors, their scope and the liability associated therewith (Chapter VII). The overall picture is supplemented by another important piece of the entire corporate governance framework puzzle, i.e. the role of soft law, self-regulation and codes of best practices for public companies (Chapter VIII). Final Chapter IX concludes the analysis and provides an outlook for further development and research.

II. The Legal Framework of the Polish Company and Capital Market Law

1. Types of Partnerships and Companies in the Polish Commercial Companies Code of 2000

The primary source of business company law regulation in Poland is the Code of Commercial Companies (CCC 2000) of 15 September 2000. The CCC constitutes a comprehensive regulation for all types of commercial partnerships and companies provided for under Polish law as well as mergers (including cross-border mergers), divisions and transformations. Both CCC and its predecessor, the Commercial Code of 1934 (CC 1934), were mainly based on the German and Austrian legal tradition.[6] While Polish law has long been under the influence of both German and French law for historical and cultural reasons (with certain recent noticeable impacts of Anglo-American law), the CCC 2000 is essentially rooted in the tradition of German company laws.[7] The choice of the German model for modernizing Polish company law is mostly due to the fact that the predecessor of the CCC 2000 – the CC 1934 was influenced by German developments to a considerable extent, i.e. the German Commercial Code of 1897. This notwithstanding, the 1934 codification earned itself an excellent reputation

---

[6] See also Sołtysiński (*supra* note 5), p. 422 who expresses the opinion that the majority of the Commercial Code rules can be characterized as a "slavish" imitation of their German models.

[7] For a description of the main features of the CCC, as well as of the sources of foreign inspiration in its drafting, see Sołtysiński, S. *Sources of foreign inspiration in the draft of the Polish Company Law (1999)* [in:] Baums, T./Hopt, K.J./Horn, N. (eds.) *Corporations, Capital Markets and Business in the Law*, Kluwer Law International 2000, p. 533; Stroiński, R., *Takeovers in Poland – current regulations and towards implementation of the takeover directive*, EBLR 2005, p. 1443. See also Sołtysiński, S. *Transfer of Legal Systems as seen by the "Import Countries": A View from Warsaw* [in:] Drobnig, U./Hopt, K.J./Kötz, H./Mestmäcker, E.J: (eds.), *Systemtransformation in Mittel- und Osteuropa und ihre Folgen für Banken, Börsen und Kreditsicherheiten* (Tübingen Mohr Siebeck 1998), pp. 70–72.

and survived until the new Millennium, although in the era of planned economy it held no practical significance.

Polish law provides for four types of commercial partnerships, i.e. the general partnership (*spółka jawna* – s.j.), limited liability partnership (*spółka komandytowa* – s.k.), limited partnership for free professions (*spółka partnerska*) and partnership limited by shares (*spółka komandytowo-akcyjna* – SKA, equivalent of the German *Kommanditgesellschaft auf Aktien*). Commercial partnerships are not formally a legal person but they do possess legal capacity i.e. they may acquire rights and obligations, sue and be sued in their own name (Art. 8 CCC[8]).[9] The main reason why partnerships (and especially the partnership limited by shares) were not granted a formal legal personality was the enabling of a structural avoidance of double taxation of corporate income provided for in Polish tax law. This paper focuses on the formally incorporated companies ("capital companies") which are the private limited liability company (*spółka z ograniczoną odpowiedzialnością – sp. z o.o.,* equivalent to the German GmbH) and the joint-stock company (*spółka akcyjna – S.A.,* equivalent to AktG, i.e. an open or public company with access to the capital market).

Both types of capital companies provided for in the CCC share some core structural characteristics of the business corporation, i.e. legal personality, lack of shareholders liability for the company's debts and transferability of its shares[10].[11] Another common feature of the limited liability company and joint-stock company is that legal capital is divided into shares which have to be paid up with contributions in cash or in kind. The limited liability company is the most popular company form for doing business in Poland[12], used by small and medium-sized enterprises (including family businesses) as well as by big multinationals for establishing their Polish subsidiaries. Similar to the German GmbH, a typical *spółka z o.o.* is a closed company with two or three (rarely more than three) share-

[8] Unless otherwise indicated, all the references shall be understood as those referring to the provisions of CCC 2000.

[9] A civil law partnership regulated in the Civil Code (Articles 860–975) does not possess legal capacity and is regarded by the majority of the doctrine as a mere legal relationship between partners.

[10] However, the Polish law contains an opt-in provision to allow that the partnership deed provide for the transferability of the aggregated rights and duties in the partnership (Art. 10 sec. 1 and 2 CCC).

[11] See Kraakman, R./Hansmann, H. [in:] Kraakman, R./Armour, J. /Davies, P./ Enriques, L. /Hansmann, H./ Herig, G./ Hopt K.J./Kanda, H./Rock, E. *The Anatomy of Corporate Law. A Comparative and Functional Approach*, Oxford University Press 2nd ed. 2009, p. 5.

[12] According to the data of the Polish Central Statistical Office (GUS), there were 216,887 limited liability companies registered in Poland at the end of 2007.

holders who often work for the company and are involved in managing its affairs.

The joint-stock company is typically the legal form for the enterprises looking for access to the wide range of investors on the organized capital market.[13] The joint-stock company is subject to a mandatory legal regime. According Art. 304 sec. 3 and 4 CCC, which is based on the German provision of sec. 23 para. 5 *Aktiengesetz*, ("*Satzungsstrenge*") a company's articles may only incorporate provisions different from those provided for by law if the law so permits. The articles may incorporate additional provisions unless the law provides sufficient regulation or such additional provision of the articles would be in conflict with the nature of the joint-stock company or good practice. In spite of a striking resemblance to its German prototype, the CCC 2000 is set in a slightly different regulatory setting, in that Polish law allows for a broader range of opt-outs and opt-ins so that some degree of contractual autonomy with regard to internal structure of the company is left up to the shareholders. The 'in principle' mandatory character of the law governing the joint-stock company is welcomed by the majority of the Polish doctrine which justifies it with the need to protect minority shareholders (in particular investors on the capital market) and stakeholders (in particular company's creditors).[14] Moreover, the reference to the nature of joint-stock company provides an explicit legal basis for a doctrinal definition of the "nature of the company", promoting a more functional approach to legal interpretation. For similar reasons some CCC 2000 commentators take the surprising view that the limited liability company is in principle also governed by mandatory provisions.[15] However, the legal regime of the limited liability company is far more flexible than the regulation of joint-stock company as far as the internal company's structure and the rights of shareholders are concerned.

2. Capital Market Law

The core of the Polish capital market law is contained in three Acts adopted by the Polish Parliament on the same day, i.e. 29 July 2005. These

---

[13] The number of registered joint-stock companies in Poland at the end of 2007 amounted to 8,853 (data of GUS). Some kinds of business, such as banking and insurance activities or management of investment funds, may be exclusively run in form of joint-stock company. Both types of capital companies have been used in privatisation process of state-owned enterprises.

[14] See Sołtysiński, S. [in:] Sołtysiński, S./Szajkowski, A./Szwaja, J. *Kodeks handlowy. Komentarz*, Warszawa 1998, t. I., at p. 78; Spyra, M. *Ochrona akcjonariuszy na publicznym rynku papierów wartościowych*, PiP 2/2000, at p. 70.

[15] See, e.g., Szajkowski, A./Tarska, M. [in:] Sołtysiński, S./Szajkowski, A./ Szumański, A./Szwaja, J. *Kodeks spółek handlowych. Komentarz*, Volume II, Warszawa 2005, at p. 80.

are: (1) the *Act on Trading in Financial Instruments*, (2) the *Act on Capital Market Supervision*, and (3) the *Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organized Trading, and Public Companies*.[16] These three acts[17] are further supplemented by a set of detailed ordinances issued by the Minister of Finance as well as by the regulations of the consolidated (market and prudential) supervisory commission: the Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego* – KNF).

Under the influence of capital market law, the originally unified legal concept of the joint-stock corporation provided for in the company law is slowly but surely being subdivided into two categories: *the public company*, which covers stock corporations listed on the stock exchange, and is subject to a growing number of special regulations contained in the CCC 2000 as well as in the capital market law; and the *non-public company* which is a non-listed corporation not active on the organized capital market. According to the definition provided in the *Act on Public Offering (...) and Public Companies*, the public company is a joint-stock company in which at least one share is dematerialised.[18] Securities put on public offer or admitted to trading on a regulated market, are dematerialised, i.e. they exist only in an non-certificated form from the date of their registration under the registration agreement with the depository for securities, concluded between the issuer and the central depository and settlement institution, the National Depository of Securities (*Krajowy Depozyt Papierów Wartościowych S.A.*) – Art. 5 (3) of the *Act on Trading in Financial Instruments*. Thus, all joint stock companies listed on the Warsaw Stock Exchange (being the only regulated market in Poland) are public companies in the meaning of the law.[19] The *Act on Public Offering (...) and Public Companies* contains many provisions concerning important corporate

[16] The three acts replaced the Act on Public Trading in Securities of 1997.

[17] Officially published in: Journal of Laws (*Dziennik Ustaw*) No. 183, items: 1537, 1538, 1539 as amended. The English translation of all three Acts is available on the Web page of the Polish Financial Authority <www.knf.gov.pl>.

[18] For justified criticism on this subdivision of joint-stock companies based only on the technical criterion of shares' dematerialisation see Grabowski, K. *Dyrektywa o niektórych prawach akcjonariuszy i jej konsekwencje dla spółek publicznych*, Quarterly for the Entire Commercial, Insolvency and Capital Market Law (HUK) 2008, No. 4, pp. 536 et seq.

[19] Public companies are also companies whose shares are admitted to Alternative Trading System "NewConnect" also organized by the WSE. "NewConnect" is a system of trading with shares of small start-up companies, which is not regulated market in the legal meaning. However, Listing Rules of "NewConnect" require dematerialization of shares as a condition of their admittance to trading in the System. Thus, by virtue of the "NewConnect" listing rules, companies whose shares are listed in the "NewConnect" are public companies in the legal sense.

governance issues in public joint-stock companies, such as disclosure of significant shareholdings, regulation of tender offers (takeover law), specials rights and obligations of shareholders (squeeze-out rights of majority shareholders, sell-out rights for minority shareholders, and rights of minority shareholders to require the appointment of special-purpose auditor). Public companies are also subject to many special regulations of the CCC 2000. The distinction between public and non-public companies has been strengthened as a result of the newest CCC amendment of December 2008 which implemented Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies. The existing dualism of joint-stock corporations has been advanced by further provisions of the CCC 2000 enacted as a consequence of the Directive's implementation. These new and unprecedented provisions include *inter alia* new rules concerning the convocation and organization of the general meeting, e.g. scope of information to be published prior to the general meeting (Art. 402^2), record date (Art. 406^1 sec. 1), voting by correspondence (Art. 411^1), and special regulations on voting by proxy (Art. 412^1 sec. 2, Art. 412^2 sec. 2 and 3). These rules only apply to public companies. It has been suggested that a similar development is underway in Germany.[20]

III. Polish Corporate Governance System as a Closed ("insider-control") System

1. General Remarks

The corporate governance system denotes the entire range of mechanism and arrangements that shape the way in which key decisions are made in large companies.[21] According to the most common typology, there are two types of corporate governance system, the insider-controlled or closed system on the one hand, and the outsider-controlled or market-oriented system, on the other.[22] This typology is based on a set of features and criteria, most importantly: the ownership structure prevailing in the majority of companies, the extent and liquidity of the capital market and its role in financing companies, the existence of markets for corporate control, the

[20] See, e.g. Habersack, M. *Wandlungen des Aktienrechts*, Die Aktiengesellschaft 2009, No. 1–2, at p. 2.

[21] See, e.g., Shleifer, A./Vishny, R.W. *A Survey of Corporate Governance, The Journal of Finance*, No. 2, June 1997, p. 737.

[22] See, e.g. Schmidt, R.H: *Corporate Governance in Germany: An Economic Perspective*, [in:] J.P. Krahnen, J.P./Schmidt R.H. (eds.), *The German Financial System*, Oxford 2004, p. 387.

role of institutional investors, the shareholder or stakeholder-orientation of corporations, and the degree of minority shareholder and investor protection provided for in corporate and capital market law. These criteria suggest that the Polish corporate governance system can be regarded as an example of the insider-controlled system, although some features differentiate it from the German bank- and stakeholder-oriented system.

2. Ownership Structure and the Role of Institutional Investors

Empirical evidence clearly indicates that ownership of Polish listed companies remains concentrated.[23] Voting control in listed companies shows a median concentration rate of 39.5%, with a sustainable trend visible over the last decade.[24] Anglo-Saxon style companies, with dispersed ownership and control exercised by managers ("Berle-Means-corporations") do not exist in Poland. This may be attributed to many factors pertaining to the origin of the Warsaw Stock Exchange. Over a long period of time the majority of most significant IPOs came through the disposal of state treasury shares held in companies subject to privatisation. Efforts made to attract individual direct investors (households) proved unsuccessful in the long term as the shares were often accumulated in the hands of one or a few controlling shareholders. Also, shares of privatized companies were concentrated in the hands of managers and other insiders.[25] Anecdotal evidence suggests strong exploitation of the private benefits of control, particularly in early 90s, both by foreign industry investors (tunnelling of resources) and managers of formerly state-owned companies (high managerial remuneration contracts). The state did not perform its monitoring function properly, giving rise to managerial opportunism. Weak competition on the market for products, particularly in the first half of the 90s was also contributing factor. Domestic companies were shielded from competitive pressure from genuinely private or foreign firms, further limiting the disciplining effect of the market.[26]

In 2005 foreign investors held the largest share of ownership in Polish companies (38% of the total amount of listed shares), followed by the public sector (20%), with individual investors (17%), private financial enterprises (17%) and private non-financial companies and organizations

---

[23] Tamowicz, P. and Dzierżanowski, M. *Ownership and Control of Polish Listed Corporations*, (October 2002), working paper available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=386822>.

[24] Tamowicz/Dzierżanowski (*supra* note 23), p. 1 and pp. 5–11.

[25] Tamowicz/Dzierżanowski (*supra* note 23), p. 3.

[26] Tamowicz/Dzierżanowski (*supra* note 23), p. 10.

(8%)[27] holding the remainder. Controlling or majority shareholders tended to be either other companies active in the same industry (creating a corporate group), or the founders of a company together with their family members. Despite the progress of privatisation, State Treasury remains a significant shareholder in a number of companies, particularly those regarded as crucial for national security or economy (e.g. oil, gas, mining, but also some banks). Moreover many joint-stock companies are family businesses controlled by their founders. This often leads to a combination of three roles for one person (or group of related entities) – that of founder, blockholder and manager.[28] Financial investors (most often banks, investment funds and pension funds) are the usually second and third biggest blockholders. Financial institutional investors are also key players who impact on the liquidity of the Polish capital market. In the first half of 2008 as much as 41% of the entire turnover of the stock traded on the WSE could be attributed to the activities of financial institutions. This figure is related to the preferred strategy usually adhered to by institutional investors while executing their corporate rights: they are more likely to exit than to vote.[29] In light of this, in 2006, two chambers associating Polish investment funds and pension funds adopted a new Code of Best Practices of Institutional Investors with a view to fostering institutional investor activism.[30] The Code is based upon a concept of the institutional investor as an active and responsible minority shareholder who exercises shareholders' rights (particularly voting rights) in matters significant for the company as well as in all corporate decisions relevant for the institutional investor's clients. Moreover, institutional investors are supposed to play a monitoring role and pursue the observance of high corporate governance standards by the company. In particular, institutional investors who hold at least 5% of the total votes are expected to participate in any general meeting. In cases where this threshold is not met, institutional investors are still supposed to attend the meeting if the agenda includes items of particular significance for the company. Institutional investors should disclose their voting behaviour and policies for the purposes of transparency.

---

[27] See FESE, *Share ownership structure in Europe*, February 2007, p. 59 <www.fese.com>.

[28] Tamowicz/Dzierżanowski (*supra* note 23) pp. 7–8; Stroiński (*supra* note 7), at p. 1447.

[29] Until recently one of the most important legal barriers impeding a more active role for institutional investors was the requirement to block shares on the securities account as a legal condition for participation at the general meeting. The requirement was abolished in result of the CCC-reform of 5 December 2008 implementing the Shareholder Rights Directive (2007/36/EC). The reform introduced i.a. the record date into the Polish law (Art. 406^1 CCC: sixteenth day before the day of the general meeting).

[30] Text of the Code is available at: <www.izfa.pl/pl/index.php?id=10042>.

There are a number of problems stemming from this concentrated ownership structure. These include: conflicts between majority shareholders and minority shareholders, private benefits of control at the expense of the minority (e.g., tunnelling of assets and profits to majority shareholders, payment of hidden dividends), and the unequal treatment of minority shareholders by company organs. Polish corporate practice also addresses cases of abuse of shareholders rights by individual investors, in particular challenging important resolutions of the general meeting in order to blackmail the company or its majority shareholders, resulting in the adoption of legislation aimed at curbing abuse by small shareholders (e.g, Art. 423 sec. 1 and 2).

3. The Polish Capital Market: Structure and Role in Corporate Finance

The central institution of the Polish capital market is the Warsaw Stock Exchange (WSE) established by the State Treasury in April 1991.[31] The Warsaw Stock Exchange itself is organized as a joint-stock company with 98% of shares held by the State Treasury. In the years 2005–2007 the WSE was the most dynamically growing market in the CEE region, competing for primacy with the Vienna Stock Exchange. It must be stated that the WSE managed to clearly outperform Vienna in terms of IPO's and the total number of companies listed (including foreign ones), as well as with respect to capitalisation and turnover.[32] At the end of the 2007, when WSE peaked in terms of value – the capitalisation of the WSE (EUR 144 billion) represented 51% of the aggregated market value of companies listed on ten exchanges of the new member states.[33] According to the same data, four out of ten (39%) companies listed in new member states were listed in Warsaw, which amounted to a total turnover of 45% of the value of all transactions in EU New Markets. In 2007, at the peak of the bull market the capitalisation of the WSE equalled to 46% of the country's GDP (in 2009 the capitalisation of the WSE fell to 34% of the Polish GDP). In 2007, with 81 IPOs (of which 12 were foreign corporations) WSE ranked second in the whole of Europe, just behind the London Stock Exchange

[31] It is worth mentioning that as many as seven stock markets were operating in Poland during the interwar period: in Warszawa, Kraków, Katowice, Lwów (Lviv), Łódź, Poznań and Wilno (Vilnius); for more information see Chłopecki, A./Sobolewski L. [in:] Chłopecki A. et al, *Prawo o publicznym obrocie papierami wartościowymi. Komentarz*, (Act on Public Trading in Securities. Commentary) C.H. Beck, Warszawa 1999, p. 22 et seq., see also Kołacz/Radwan (*supra* note 5).

[32] However, the total capitalization of the CEE Stock Exchange Group (i.e. Vienna Stock Exchange together with Stock Exchanges in Prague, Budapest and Ljubljana, being controlled by Vienna) is higher than the capitalization of WSE.

[33] Warsaw Stock Exchange Annual Report 2007 (downloadable at: <www.gpw.pl/gpw.asp?cel=informacje_gieldowe&k=9&i=/raport_roczny/raport_roczny&sky=1>, p. 32.

(99 IPOs).[34] In August 2007 an alternative trading platform (unregulated market) for financing and trading start-ups with a high growth potential was launched by the WSE under the name "NewConnect". Low listing costs, simplified admission procedures and lighter disclosure requirements were introduced with intention of allowing companies to raise capital effectively and quickly. In the end of June 2010, 136 companies were listed on the NewConnect system. Criticism of this system however has targeted the low liquidity of this market, the absence of institutional investors and alleged price manipulation.[35]

It must not be forgotten that Poland has traditionally belonged to German legal family, which is characterised by the prevalence of debt financing. Yet with the growing strength of the WSE the role of equity financing has gained in significance. The data from 2005 and 2007 show a remarkable leap in the WSE capitalisation/GDP-ratio from 32% (2005) to 43,7% (2007), while at the same the figure for bank credits declined from 32% to 14,8% of the GDP.[36] These figures have been changing in the course of the recent financial crisis with no exact figures available at the time of drafting of this article.

The dynamic growth of the Polish capital market in the years 2005–2007 should be attributed to the activity of individual private "domestic savers" investing their money mostly in investment funds promising high capital yields surpassing the profits from traditional bank deposits. However, the global financial crisis in the second half of 2008 dramatically revealed the structural weaknesses of the Polish capital market: its low liquidity, dependence on foreign speculative investors and susceptibility to price manipulation. In a couple of months the market capitalization of listed companies shrank by half (despite the principally sound fundaments of the Polish economy), the stock index slumped to pre 2005 levels. The number of IPOs in 2008 fell to only 33 (from 81 in the previous year). The supply of capital diminished dramatically as a consequence of the withdrawal of foreign institutional investors from the Polish market as well as the snowballing outflow of private capital from national investment funds. This effectively stymied the efforts of the WSE to achieve its strategic aim, i.e. to become dominant Central European trading centre. The WSE was outperformed by the Vienna Stock Exchange which grabbed control over

---

[34] Warsaw Stock Exchange Annual Report 2007 (previous note), p. 28.

[35] See Kuryłek, W. *Sklep z marzeniami, czyli NewConnect*, "Rzeczpospolita" (Polish daily), Section "Economy and Market", 24 April 2008.

[36] See Słomka-Gołębiowska, A. *Czy banki wypełniają lukę w ładzie korporacyjnym w Polsce,* Quarterly for the Entire Commercial, Insolvency and Capital Market Law (HUK) 2007, No. 1, p. 20; Sobolewski, P./Tymoczko, D. (eds.), *Rozwój systemu finansowego w Polsce w 2007 r.* (study of the Polish National Bank downloadable at: <www.nbp.gov.pl>, p. 6.

two other Stock Exchanges in the region (Budapest and Prague). The main reason for this failure is seen in the fact that WSE is until now 98% owned by the Treasury State. This is about to change very soon. After a failed attempt sell the controlling block to a foreign competitor (European or US stock exchange), a new approach prevailed. This new approach, which is currently in process of implementation, assumes an IPO (scheduled for November 2010) and sale of the majority of stock held by the State via the market. Although 63,8% of total stock will be sold to individual and financial investors, the State has made an attempt to retain control via voting caps. The conformity of these caps with EU Law (golden shares) is controversial. This swift privatisation of the WSE is perceived as a precondition of further (also technological) development of the Exchange and the strengthening of its position in the region. Still, with 383 companies (including 25 foreign companies) listed on the regulated market (June 2010) and 136 companies listed on the NewConnect alternative investment market, the Warsaw Stock Exchange counts as one of the leaders in the Central Eastern Europe and demonstrates a remarkable potential for further growth.

This most recent financial crisis began for Poland in July 2008, and was more a reaction to the world financial crisis than as a result of domestic economic indicators. Strong criticism was made regarding the efficiency of market supervision executed by the Polish Financial Authority (*Komisja Nadzoru Finansowego*, KNF). The KNF was established in 2006 as an integrated supervisory authority over the whole Polish financial market. Prior to this, supervisory powers had been divided between three separate state entities which supervised the financial market according to activity: capital market (KPWiG), insurance and pension funds (KNUiFE) and banking sector (KNB). The consolidation aimed to achieve range of expected benefits: synergy effects, better supervision of financial conglomerates and international patterns (e.g. UK FSA, German BaFin and their Scandinavian counterparts). However, two years after consolidation, KNF's success record is ambiguous. Spectacular cases of market manipulation and insider trading, the perpetrators of which often go unpunished, still happen on the Polish financial market. In addition, the recent currency options crisis that severely affected a substantial number of Polish firms (both listed and non-listed) is attributed to the passivity of the national supervisor.[37] Much remains to be done in order to improve the efficiency of KNF supervision and enforcement.

[37] Czech, M. *Opcja kompromitacja*, Gazeta Wyborcza (Polish daily), 8 March 2008.

4. Market for Corporate Control and Takeover Law

Due to the concentrated ownership and control structure prevailing in Polish companies and other structural barriers (e.g. low liquidity of the trade, insufficient number of banks and law firms specialised in takeovers), the market for corporate control plays only a minor role as an element of external corporate governance disciplining managers. According to Tamowicz and Dzierżanowski, only up to 20% of Polish public companies may be subject to hostile takeovers.[38] Takeovers and mergers in most cases have a friendly character. However, from time to time spectacular hostile takeover attempts also take place in Poland.[39]

Takeover regulations in Poland are primarily contained in Chapter 4 ("Material Blocks of Shares in Public Companies") of the Act on Public Offering (...) and Public Companies (further: the Act) and in the CCC.[40] The Act provides for *two kinds of compulsory partial bids* in the event of acquisition of small blocks of shares which increase a shareholder's share in the total vote by more than:

- 10% within a period of less than 60 days – in the case of a shareholder holding less than 33% of the total vote at the company,
- 5% within 12 months – in the case of a shareholder holding 33% or more of the total vote at the company.

These kinds of acquisition may be effected *only* by way of a tender offer to acquire or exchange the given number of shares (Article 72 sec. 1 of the Act). There is also an obligation to make a compulsory partial bid where a shareholder aims to acquire a number of shares that would result in a holding of over 33% of the total vote in a company. Acquisition of shares exceeding this threshold requires a partial bid. The partial bid must address the number of shares conferring the right *to at least 66% of the total vote*, unless the 33% threshold is to be exceeded as a result of a tender offer aimed at acquiring all residual shares of the company (Article 73 s1 of the Act). A *mandatory bid* covering all residual shares of the offeree company is required where a shareholder intends to exceed 66% of the total vote in

---

[38] Tamowicz/Dzierżanowski (*supra* note 23), p. 15.

[39] Most recently (2008) the hostile takeover of the jewellery firm W. Kruk SA (WSE listed company, in which significant shareholders were members of Kruk family) by V&W SA, another public company active in clothing industry striving to broaden and diversify of its activity. The takeover was successful, but the V&W SA was in turn taken over by Mr Kruk acting in concert with other investors. Finally, the friendly two companies, i.e. the bidder and the offeree company, have been merged according to the provisions of the CCC.

[40] See, with regard to details, Bobrzyński, M./Oplustil, K./Spyra, M. [in:] Maul, S./ Muffat-Jeandet, D./Simon, J. (eds.), *Takeover bids in Europe. The Takeover Directive and its implementation in the Member States*, Freiburg i. Br. 2008, pp. 453 et seq.

that company (Article 87 sec. 1 of the Act). That mandatory bid may also satisfy the terms of Article 5 of the Takeover Directive, as it must cover all residual shares of the offeree company. However, contrary to the requirement of the Directive (Article 5 sec. 3), Polish law does not explicitly define what percentage of voting rights determines control of the company. It may be presumed that this is 66% of the total vote, even though that threshold may be considered too high as the majority shareholder is already in control of the company. Thus, the Polish regulation jeopardises the purpose of Article 5 of the Directive, i.e. to give the minority shareholder the chance to exit the company once a change in control has taken place.[41]

The Act also provides regulations concerning the obligations of management and supervisory board members of the offeree company with regard to takeover bids. It has to be stressed, that the relevant Takeover Directive provisions were only implemented in September 2008. The Polish lawmaker made use of the opt-out from the Directive's duty of neutrality rule (non-frustration, Art. 9 of the Directive) and the breakthrough rule (Art. 11 of the Directive). Public companies subject to Polish law have an option to amend their articles in order to implement one or both of these rules (Art. 80a-80d of the Act).

The CCC provides some important provisions allowing a company's articles to implement "control enhancing mechanisms" which are capable of discouraging takeover attempts.[42] These mechanisms have the following important features:

- *voting caps*: The company's articles may limit voting rights of a shareholder who represents over one-tenth of the aggregate number of votes in the company.[43] This limitation applies only to shares exceeding the limit laid down in the company's articles (Art. 411 sec. 3). The articles may also provide for an accumulative counting of votes held by corporate shareholders remaining in a parent-subsidiary relationship and lay down exact provisions on how these votes shall be reduced (Art. 411 sec. 4);

---

[41] See also critical remarks by Opalski, A., *Europejskie prawo spółek*, Warszawa 2010, p. 511.

[42] The application and proliferation of various CEMs in Poland has been discussed on a basis of anecdotal evidence in Report on the Proportionality Principle in the European Union, Brussels, 18 May 2007, pp. 109 et seq.

[43] The threshold was lowered from one-fifth to one-tenth of the aggregate number of votes in result of the reform of the CCC of 29 May 2009. Accidentally this coincides with the provisions as laid down in the articles of incorporation of PKN Orlen, the Polish leading petroleum company. One could be surprised to see the law being adjusted to the company's articles rather than the other way round.

- *multiple voting rights*: The CCC 2000 abolished the multiple voting rights in public companies which had existed under the previous CCC 1934.[44] However, rights existing before the enactment of CCC (1 January 2001), do not expire and remain governed by the old provisions. Thus, some companies listed on the WSE have preserved their multiple-voting rights (up to 5 votes pro share, i.e. maximal voting privilege according to CC of 1934);
- *shares without voting rights* (known as "numb shares") are allowed without any limitation on their percentage in relation to the total amount of shares (Art. 353). As an exemption to the general rule, under which all privileged shares must be registered shares, shares without voting rights are classed as bearer shares and thus can be traded on the regulated market;
- *personal rights conferred in the company's articles upon an individual shareholder*: These rights may concern, in particular, the authorisation to appoint or remove members of the management board or the supervisory board (Art. 354 sec. 1). The adoption of an amendment of the articles providing for the restriction or removal of these personal rights requires the consent of all shareholders concerned (Art. 415 sec. 3),
- *"golden share" of the State Treasury:* A special Act of Parliament provides the State Treasury with special rights over a number of companies which are considered materially significant for public order and security.[45] These rights include, inter alia, the right to oppose a general shareholder meeting resolution or an action of the management board in specific matters that are essential for the existence and functioning of the company: including the winding-up of the company, the transfer of the company's seat abroad, a change in the company's operations (i.e. the scope or object of business activity) as laid down in the company articles, as well as any disposal, leasing, pledging or creating usufruct on its organized assets.

Thus, Polish company law allows for substantial deviations from the proportionality principle.

---

[44] In non-listed joint-stock companies one share can carry up to two votes (Art. 352 CCC).

[45] The Act of 3 June 2005 on special rights of the Treasury of State and on their execution in capital companies of material significance for the public order and public security, Journal of Laws (*Dziennik Ustaw*) from 2005, No. 132, pos. 1108 as amended. The list of the companies to which the Act is applicable is laid down by the Council of Ministers in a way of an Ordinance.

5. The Notion of Company's Interest and Shareholder Value

The matter of the "company's interest" is perceived as a fundamental determinant of the operation of the company's authorities and is frequently applied as a benchmark in assessing the legality of a given corporate action. Prevailing legal doctrine tends to interpret the notion of company's interest as a "result" or outcome of balancing the interests of persons involved in the company. Interestingly, this includes shareholders as wells as stakeholders (e.g. creditors, employers, suppliers), although, according to leading opinion, the interests of shareholders should play a superior role in defining company interest. This means that the members of the management board and supervisory board cannot give priority to the economic interests of stakeholders before the interests of shareholders as a group. The interests of stakeholders should be respected in so far as they are covered by protective legal provisions (e.g. labour law, insolvency law, consumer law, banking law) and any extension of legal protection stemming from corporate law is generally allowed only if it can be aligned with the interests of shareholders as a group.[46] However, exceptional case-law extends the notion of company interest to accommodate other stakeholders' perspective. This is illustrated by the Appeal Court judgment in Łódź (7 March 1994).[47] This decision, regarding a capital increase for a bank, justified the exclusion of existing shareholders (pre-emption right) to streamline the capital supply and strengthen the financial condition of the bank, which would in turn benefit the interests of bank account holders (depositors). It follows from that rationale that bank account holders might be perceived as stakeholders whose interests contribute to the interpretation of the company's interest as a whole.[48]

This notion of the company interest which, according to the British interpretation, can be described as the "enlightened shareholder value", was reflected in the Corporate Governance Code ("Best Practices Code") of 2005 (no longer in force). According to the first rule of the Code, the basic objective for a company's representatives is to further the interest of the company, i.e. to increase the value of capital invested by its shareholders, with consideration to the rights and interests of constituencies other than shareholders, involved in the functioning of the company, including, in particular, the company's creditors and employees. In addition,

---

[46] Opalski, A. *O pojęciu interesu spółki kapitałowej*, Przegląd Prawa Handlowego 2008, No. 11, pp. 16 et seq.

[47] ACr 21/94, published in: Wokanda 1994, No. 11, p. 54.

[48] See Okolski, J./Modrzejewski, J./Gasiński, L. *Natura stosunku korporacyjnego spółki akcyjnej*, PPH 2000, No. 8, p. 11; Okolski, J./Modrzejewski, J./Gasiński, L., *Zasada równego traktowania akcjonariuszy na gruncie k.s.h.*, PPH 2002, No. 10, p. 24; Radwan, A. *Prawo poboru w spółce akcyjnej*, Warszawa 2004, p. 275.

a specific rule contained in the section pertaining to the board's duties recapitulates the overlying role of company's interest by stating that the management board, when establishing the interest of the company, should keep in mind the long term interests of the shareholders, creditors, employees and other entities and persons cooperating with the company, as well as the interests of local community. However, the new Best Practices Code of 2007 repealed this broad definition leaving the determination of company interest up to the managers, commentators and ultimately to the courts.

It should also be mentioned here that Polish law provides for a certain degree of workers' codetermination. Employees in former state-owned enterprises have the right to elect supervisory board members.[49] The reason for allowing for worker codetermination in these companies is to compensate for the previous framework of worker participation in decision-making in state enterprise.[50] Thus, employees retain a limited possibility to influence the determination of the company's interests through their representatives in the company's management organs.

Empirical research into the impact of banks on companies' dealings and decision-making revealed a weak influence of the banks on corporate governance of public companies (for the years 1999–2002).[51] The supervisory boards of almost half of the companies surveyed had at least one bank representative – usually the major creditor of a given company. However, banks are rather reluctant to engage themselves in the decision making process in companies to whom they extend credit, which might be explained by the rational aversion to legal risk associated with a conflict of interests and of violation of the rules prohibiting insider dealing.

---

[49] In these companies the employees are entitled to elect two of five members of the supervisory board. Moreover, in companies with average yearly employment of more than 500 employees, they are entitled to elect one member of the management board. With regard to details see Articles 11–16 of the Act of 30 August 1996 on Commercialisation and Privatisation, Journal of Laws (*Dziennik Ustaw*) of 2002, No. 171, item 1397 as amended.

[50] Under the Act on State Enterprises of 1981 (still in force) the *state enterprise* is a *sui generis* legal form (different from the commercial company) with its own organs, one of them being the "workers council" (*rada pracownicza*).

[51] See Słomka-Gołębiowska (*supra* note 40), p. 29.

IV. Influence of EC law on Polish Company Law

1. Impact of Brussels

a) First and Second Stage Directives

EC-law has significantly influenced Polish company law. Full harmonisation of the Polish law with the *acquis* requirements was one of the main reasons for the adoption of the new CCC 2000. The overwhelming majority of the EC company law directives have been implemented in the CCC (including the Third, Sixth and Tenth Company Law Directive). EC-directives concerning financial reporting (Fourth and Seventh Directive) were implemented in the Act on Accountancy of 1994 (*ustawa o rachunkowości*). The implementation of the Shareholder Rights Directive (2007/36/EC) required significant amendments to the CCC. Those amendments have been introduced by an Act adopted on 5 December 2008 which came into force on 2 August 2009. The harmonisation of Polish law with the Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts was finally accomplished (with a delay of nearly one year) with the Act of 29 May 2009 regulating the tasks of statutory auditors, their operations and self-government as well as the system of public oversight for the statutory auditors and audit firms.[52]

It must be stressed that, due to the historical affinity of the Polish company law with the German system, the implementation of the First and Second Company Law Directive did not require fundamental changes in the law, as third party protections had already been based on the disclosure of company's documents in the public register. The debate regarding the powers of directors which occurred in Europe in the 60s (*ultra vires* vs. unlimited representation by company organs), did not require any changes to Polish law, the prevailing doctrine (see Art. 9 of the First Directive) was already in force through the pre-existing approach (CC 1934) which gave priority to legal certainty over shareholders' autonomy. Also creditor protection by means of a legal capital regime was deeply rooted in the Polish legal tradition. Yet some changes were needed to fully align national law with *acquis* requirements, these included refining the legal framework for share buy-backs, introducing constraints to the availability of financial assistance, and upgrading the provisions on contributions in kind in the formation process, in the immediate post-incorporation timeframe as well as in case of the capital increase. Moreover an unprecedented power to issue new shares was vested in the board, breaking the "monopoly" of the

[52] Ustawa z 29 May 2009 r. o biegłych rewidentach i ich samorządzie, podmiotach uprawnionych do badania sprawozdań finansowych oraz o nadzorze publicznym, Journal of Laws (*Dziennik Ustaw*) of 2009, No. 77, item. 649.

general meeting on capital increases (authorised capital). The same is true for the Sixth Company Law Directive providing for a new set of rules on spin-offs, previously unknown in the Polish system. It is worth mentioning that many rules designed by the EC-legislator to apply only to joint-stock companies are routinely extended to closed companies as well. This has to do with basic deeply-rooted presumption in Polish doctrine that a closed company and a public company share the same basic features with respect to creditor and minority protection and thus should be governed by a similar legal regime.

Other company law directives did not revolutionise Polish law either. This is explained by the fact that early directives bore a strong German influence, which in turn was to a significant extent "directly", (i.e. without European intermediation) reflected in the Polish pre-war legislation. What is more, later at implementation stage, the adoption of the *acquis* in Poland occurred in part through the direct importation of "prefabricated" modules of German law into the Polish CCC. This approach brought the clear advantage of having new rules in a pre-digested form, i.e. pieces of European legislation fit for transplantation into a legal system characterised by cultural affinity to the "donor". This applies to a wide range of directives, with the most striking example seen in authorised capital (Art. 444–447) almost a copy-and-paste "legal module" from the German *Aktiengesetz* (sec, 202–206). It should be stressed that this is welcomed as a rational strategy of importing public goods at no significant cost, or – putting it in an international context – a unique example of legitimate free-riding with no externalities.[53]

b) Third Stage Directives

A somewhat different assessment is warranted by the impact of third stage directives, including the Takeover Directive (2004/25/EC), the Shareholders' Rights Directive (2007/36/EC) and the Directive 2005/56/EC on cross-border mergers of limited liability companies (Tenth Company Law Directive). The two most recent directives contributed to a far-reaching revision of Polish law. Until the implementation of the Shareholders' Rights Directive Polish law provided a framework quite hostile to the participation of individual investors, including restrictions on proxy voting, blocking of shares in the pre-meeting period, limited minority influence on the GM (General Meeting) agenda, and a very conservative approach to the use of IT and electronic communication with respect to the meeting. Equally conservative approaches could be identified in the field of cross-border restructuring, as Polish law did not allow any form of transnational

[53] See Radwan (*supra* note 1), p. 7.

mobility for companies. While cross-border merger became available to Polish companies as a result of the ECJ's judgement in the Sevic case[54] and the implementation of the Tenth Directive, seat transfer remains prohibited (Art. 270 No. 2; Art. 459 No. 2 – forcing mandatory dissolution in the case of an attempted seat transfer).

Another peculiarity arose from implementation of the Takeover Directive. From their "rebirth" back in the early 90s, Polish capital market regulations were influenced by the French and Anglo-Saxon model. This resulted in the incorporation of rules into Polish law triggering off mandatory bids for a number of situations, *inter alia* once the acquirer passed the voting threshold of 50%. During the implementation of the takeover directive, a peculiar solution has been adopted by the Polish legislator, namely the acquisition of shares resulting an overstepping of the 33% threshold triggers a partial bid aimed at acquiring at least 66% of the total vote. Once the higher threshold of 66% is passed, another mandatory bid targeting all outstanding shares has to be made, making use of the opt-out from the Directive's duty of neutrality rule (non-frustration, Art. 9 of the Directive) as well as the breakthrough rule (Art. 11 of the Directive).

2. Impact of Luxembourg

The examples given above pertain to the influence of secondary EC legislation. Another dimension needing examination is the potential impact of primary EC-law, i.e. Treaty provisions on the freedom of establishment and capital movement. It is well known that ECJ case-law based on those two fundamental freedoms contributed to a dramatic change in the corporate landscape in Europe giving rise to the phenomenon of regulatory competition (keyword: companies mobility[55]) and dismantling protectionist measures against foreign investors (keyword: golden shares[56]). A consequence thereof was the wave of 'pseudo-foreign companies' proliferating rapidly in countries adhering to strict capital regimes, such as Germany, the Netherlands or Denmark. Taking into account the relative cost of incorporating a company in Poland (among the highest in Europe) one could

---

[54] ECJ judgment of 13 December 2005, Case C-411/03 SEVIC System AG ("Sevic"), E.C.R.-I, 10805.

[55] See the Centros decision (ECJ Case C-212/97 (Centros Ltd. v. Erhvervs- og Selskabsstyrelsen, decision of 9 March 1999, E.C.R. I-1459,) the Überseering decision (ECJ Case C-208/00, Überseering B.V. v. Nordic Construction Company Baumanagement GmbH (NCC) and the Inspire Art decision (ECJ Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., decision of 30 September 2003).

[56] See, e.g. ECJ judgments of 4 June 2002 in cases: C-367/99 (Commission vs. Portugal), C-503/99 (Commission v. Belgium), C-98/01 (Commission vs. United Kingdom).

reasonably expect a similar outburst of imported "ltds" in this part of Europe – but, this did not happen.[57] Therefore Poland has not experienced a similar "cohabitation" of domestic and foreign firms that would force a direct confrontation of diverging legal concepts with the result that the impact of the *pro-libertate* ECJ rulings on Polish company law remained rather limited. The recent reduction in the minimum capital requirement (CCC reform of 23 October 2008, see below) resulted more from a European "fashion" than from a sophisticated and coherent law reform. This having been said, some influences of the ECJ "golden-shares" jurisprudence have been reflected both in Polish case law[58] and in the Act on special rights of the Treasury of State, as well as their implementation for capital companies considered of material significance for the public order and public security (3 June 2005).[59]

V. Foreign Inspirations and their Impact on Polish Company Law – the Polish Experience with Legal Transplants

1. The Economics of Lawmaking in a Transforming Economy

Given limited resources, such as human capital and efficient institutions (courts and academia) on the one hand, and growing demand from the business environment for an adequate legal framework – on the other, the import of legal concepts and institutions proved to be the most cost-effective and sometimes the only affordable way of reducing existing discrepancies in legal sophistication in order to address the needs of the transforming economy.[60]

However, a frequent lack of a proper theoretical setting for imported legal tools did result in some negative consequences for the coherence and efficiency of law. For a long time, however, spending scarce resources on the import of legal concepts and know-how as well as on the search for practical and quick solutions to the emerging problems of everyday commercial dealings has yielded a higher marginal utility for the economy as a

---

[57] Becht, M./Mayer, C./Wagner, H.F. *Where Do Firms Incorporate?*, ECGI Law Working Paper No. 70/2006, p. 30.

[58] See judgment oft the Polish Supreme Court of 30 September 2004 (IV CK 713/03).

[59] The Act of 2005 was replaced by the Act of 18 March 2010 on special rights of the Minister of the Treasury of State as well as on their implementation for capital companies and group of companies in energy, petroleum and gas petrol sector (Journal of Laws of 2010, No. 65, item 404). The right of the Minister to oppose certain business decisions in those companies is no more linked to the shares belonging to the State Treasury.

[60] See Radwan (*supra* note 1), at p. 6.

whole than could reasonably be expected from investing in the methodical build-up of the entire system of business law, starting from its theoretical, i.e. dogmatic and economic foundations.[61] The corresponding opportunity cost included an underdeveloped 'identity' of business law (both in its production and application), which in turn has led to inefficiencies and legal uncertainty. One might rightly be inclined to perceive contemporary Polish business law, and company law in particular, as an aggregate of individual legal provisions united merely by formalistic rules of legal interpretation.[62] In spite of the frequent wholesale import of legal institutions, no formal transplantation methodology has ever been developed in Polish jurisprudence. Given the extent of the legal transplant phenomenon one could reasonably expect quite the opposite, i.e. an increase in scholarship dedicated to conscious and proper borrowing of legal approaches and institutions.

2. Sources of foreign inspiration

Not surprisingly the primary source of inspiration was German corporate law. As stated above, a process of wholesale transplantation took place in the course of aligning Polish law with the *acquis*, where German law played a role of a transmitter. However, it would be too simplistic to claim the current Code resulted from the slavish imitation of German laws. The legislative inspirations include Germany, the Netherlands, Belgium, France, Hungary and Slovenia. Yet the impact of foreign legislation other than that of Germany appears to remain rather limited.

3. Case Study: Squeeze-out

As an example we may refer to squeeze-out provisions – an institution introduced into the Polish CCC a year in advance of Germany. According to the official legislative motives of the CCC 2000, Polish regulation was modelled on the Dutch, French and Belgian laws.[63] On closer investigation the solution found in CCC bears some peculiarities. First, contrary to virtually all foreign counterparts, CCC 2000 limited the scope of application of the squeeze-out rule to non-listed companies (see Art. 418^1 sec. 8). This is surprising as comparative studies reveal the existence of two models of

---

[61] See Radwan (*supra* note 1), p. 7.

[62] Adherence to legal formalism is not limited to the areas of company and commercial law, it also prevails in administrative law cases pertaining to business entities, cf. Galligan, D./Matczak, M. *Strategies of Judicial Review. Exercising Judicial Discretion in Administrative Cases Involving Business Entities*, (2005) Ernst & Young Better Government Paper Series, Warsaw 2005; see also Radwan (*supra* note 1).

[63] See the official legislative motives, Parliamentary Document (Druk Sejmowy) No. 1687 of 4 February 2000, p. 48.

squeeze-out: either covering both listed and non-listed companies or embracing listed companies only. Against this comparative background Polish rules must be assessed as somehow exotic and apparently random. No convincing reasoning to support such an option has ever been put forward. What is more, the decision to proceed with the compulsory acquisition of shares was made subject to the resolution of shareholder meetings – a unique choice internationally – at least until Germany followed suit (see sec. 327a-327f AktG introduced in 2001 by WpÜG – reverse transplant?). It was not until 2005 when a parallel framework was put in place for public (listed) companies – as a result of implementing the Takeover Directive (see Art. 82 *Act on Public Offering (...) and Public Companies*). Under Art. 82 *Act on Public Offering (...) and Public Companies* the threshold entitling a squeeze-out of the minority was raised to 90%, lower than the 95% required by the CCC (95%). Moreover no approval by the general meeting is required under the Act. As a result, a legal dualism exists, where two separate sets of rules govern the squeeze-out procedure in listed and non-listed companies.

4. Case Study: Shareholder Loans

Two other examples of an apparent transplant – this time directly from German law– are the regulation of shareholder loans (Art. 14 sec. 3) and the pre-incorporation entity (company in organization – Art. 11–13). Whereas the latter addressed an issue of undeniable practical significance,[64] the former appeared somehow artificial, as there was neither case law nor legal writing dealing with that issue. This lack of legislative roots rendered the rules on shareholders open to occasional misunderstanding. The underlying idea in Germany was that any capital injection rendered by shareholders to the company in a way other than by means of ordinary capital increase should be converted into subordinated debt. This rationale was somehow lost in the transplant, as the rule tends to be interpreted by its commentators in a quite formal manner. According to the Art. 14 sec. 3 a receivable debt to a shareholder in respect of a loan granted to a company shall be considered a contribution to the company in the case where the company is declared bankrupt within two years from the day of conclusion of the loan agreement. This is being interpreted strictly and formally as encompassing debts stemming from loan agreements only, and not extended to include merchant credit or any other forms of postponed payment.[65] What is more, contrary to the German model, the Polish rules

[64] See Sołtysiński (*supra* note 3), p. 287 and 291.

[65] See Szumański A. [in:] Sołtysiński, S./.Szajkowski, A/Szumański, A./Szwaja, J. *Kodeks spółek handlowych. Komentarz*, Volume I, Warszawa 2006, pp. 260 et seq.

apply to all shareholders, irrespective of the stake in the company, which disregards the corporate status of insignificant shareholders, who despite their position as members (*de iure*), are *de facto* qualified as outsiders.

5. Case Study: Mergers

Yet another example of accidental transplantation would appear to have been delivered by Art. 509 sec. 3. According to this provision, the resolution approving a merger may not be challenged for objections relating only to the exchange ratio of shares. This wording resembles Sec. 14 para 2 of the German law on transformation (*Umwandlungsgesetz*). But it is not the wording that brings about the suspicion of ill-tuned transplantation. It needs to be pointed out at the regulatory context – while in Germany the rule is supplemented by special appraisal provisions (*Spruchverfahrensgesetz* 2003), there is no such framework in the Polish system. As a result, the transplant has been put in a quite different regulatory context. This missing piece of the puzzle contributes to the worsening of the minority shareholder position; they are left with the vague remedy of seeking redress according to general rules of the Civil Code (see Art. 415 of the Civil Code laying down the general legal basis for tort liability).

6. Legal Transplants in Poland – A Summary

As indicated above, the most important impact on the current Code can be attributed to German law, particularly for joint-stock company law, some of the passages or even entire subchapters bear a striking resemblance to their *Aktiengesetz* prototypes (particularly *genehmigtes Kapital*[66] and *bedingtes Kapital*[67]). However, the German-inspired statutory laws have been to some extent overlapped by legal practice (including forms and covenants) applied by large law firms, the majority of which is either part of a multinational chain or has borrowed Anglo-Saxon *modus operandi* and know-how. Additionally, the attitude of the courts is characterised by the formalistic application of law in a manner much stricter than that of Germany.[68] All this creates an interesting patchwork-system, where the written

---

[66] Resembling the Anglo-Saxon *authorized capital*, i.e. the power granted to the board of directors to increase capital by share issuance – see Art. 444 et seq CCC.

[67] The idea is to enable the company to carry out a kind of *conditional capital increase*, where new shares are issued upon the condition that the entitled individuals (e.g. holders of convertible bond or holders or warrants) decide to exercise their conversion or subscription rights see Art. 448 et seq. CCC.

[68] See a survey embracing administrative business law, whose findings however are to a similar extent applicable to commercial and company law cases: Galligan/Matczak (*supra* note 62).

laws are modelled on German legislation, but handled in a different way by judges and attorneys.

A recent (October 2008) development in Polish company law cannot be overlooked. This featured a dramatic reduction of minimum capital requirement from 50 000 Złoty (approx. 11 000 €) to 5000 Złoty (approx. 1100 €) for a limited liability company and from 500 000 Zloty (approx. 110 000 €) to 100 000 Zloty (approx. 22 000 €) for a joint stock company. This reduction occurred as a reaction to a parallel development in Europe. The amendment was accompanied by a package of wide-spread liberalisations of the legal business framework in Poland. However, the recent amendment appears somehow accidental and arbitrary as capital reduction was implemented in isolation from the complex revision of the creditor protection system in Poland, despite the existence of several profound studies in the literature advocating a well thought-through system change.[69]

VI. Internal Structure and Allocation of Powers in the Polish Limited Liability and Joint Stock Company

1. Limited Liability Company

In a limited liability company there are two obligatory corporate bodies, i.e. the management board and the shareholders meeting. Establishment of a supervisory board is, in principle, not obligatory because right of supervision and inspection over company's affairs is conferred upon each shareholder (Art. 212). The articles of a company may provide for the establishment of a supervisory board or auditors' committee or both these bodies (Art. 213 sec. 1).[70] Whenever one of these bodies has been established, the articles may exclude or restrict individual control by shareholders, which is often the case in larger companies with a relatively large number of shareholders. Furthermore, establishment of the supervisory board is

---

[69] Opalski, A. *Kapitał zakładowy: Skuteczny instrument ochrony wierzycieli czy przestarzała koncepcja prawna? Próba porównania modeli ochrony wierzycieli w prawie państw europejskich i Stanów Zjednoczonych,* Kwartalnik Prawa Prywatnego, 2002, No. 2, pp. 435 et seq.; Radwan, A. *Sens i nonsens kapitału zakładowego – przyczynek do ekonomicznej analizy ustawowej ochrony wierzycieli spółek kapitałowych* [in:] Cejmer, M./.Napierała, J./ Sójka, T. (eds.), *Instytucje prawne dyrektywy kapitałowej*, Volume II, Kraków 2005, pp. 23 et seq.; Oplustil, K. *Reforma kapitału zakładowego w prawie europejskim i polskim* [in:] *Kodeks spółek handlowych po pięciu latach*, Wrocław 2006, pp. 551 et seq.

[70] In practice if shareholders decide to set up a supervisory body they tend to go for the supervisory board rather than the auditors' committee, so for the sake of simplification we limit our analysis to the supervisory board.

obligatory in companies with more than 25 shareholders, whose share capital exceeds 500,000 PLN (Art. 213 sec. 2). This regulation, already rooted in the Commercial Code of 1934, is a (modified) legal transplant from Austrian law containing a similar provision applicable to limited liability companies who as a matter of their ownership structure and capital equipment, resemble a typical joint-stock company (see sec. 29 (1) No. 1 of the Austrian Act of Limited Liability Company of 1906). The management board must be composed of one or more natural persons and represent the company and manage its affairs. Members of the management board are appointed for a specified or unspecified term by a resolution of shareholders unless the articles of company provide otherwise (Art. 201 sec. 4). In particular, a company's articles may grant any given shareholder a right to appoint one or more directors. Each member of the management board may be dismissed by a resolution of shareholders at any time and without cause. The articles may incorporate other provisions, specifically, to restrict the right to remove a member of the board to important reasons (Art. 203 sec. 2). Removal from the management board does not deprive the dismissed member of the rights resulting from the contractual relationship with the company (e.g. employment or managerial contract, Art. 203 sec. 1).

Whether shareholders of a private limited company may give binding instructions to the management board concerning the management of company's affairs is quite a controversial issue in the Polish legal doctrine. The majority of commentators hold the opinion that giving these instructions is legally possible.[71] This opinion stems firstly from the nature of *spółka z o.o.* which is typically a company with a small number of shareholders personally involved in its activity. Secondly, a statutory basis for this opinion may be found in Art. 207 CCC 2000 according to which the relationship of members of the management board to the company is subject to restrictions determined in the articles of company and, unless otherwise provided in the articles, *in resolutions of shareholders.* This provision indicates that resolutions of shareholders are, in principle, binding for

[71] Szumański [in:] Sołtysiński et al. (*supra* note 15), pp. 508 et seq.; Opalski, A./ Wiśniewski, A.W. *W sprawie autonomii zarządu spółki z o.o. – polemika*, PPH 2005, No. 1, p. 52. Opposite opinion was presented by Szwaja, J./. Kwaśnicki, R.L *W sprawie wykładni nowego Art. 375[1], a także Art. 375, Art. 207 oraz Art. 219 § 2 k.s.h.*, PPH 2004, No. 8, p. 32 arguing that – as a general rule – directors are liable for damages inflicted upon company by their own wrongdoing (Art. 293) and therefore they should not be charged if the damage arises from an action undertaken under shareholder instructions. This opinion is unconvincing because each director can challenge the shareholders' resolution if it is considered to be unlawful or detrimental to the company's interest. The directors shall not be liable for the implementation of economically abortive shareholders' decisions.

managers. Thirdly, for limited liability company, the CCC 2000 does not explicitly exclude the power of shareholders to give binding instructions to the directors of a limited company, unlike under the Code's rules pertaining to the joint-stock company (Art. 375^1, see below), where a literal provision formally immunises directors from the direct influence of shareholders as a group. The practical significance of this controversy is rather limited because of the ability to dismiss a member of the management board at any time without cause. Thus, managers, who do not follow shareholders' instructions, expose themselves to a prompt dismissal from the board. However, managers should not follow instructions which are unlawful or violate the provisions of the company's articles. Each individual manager as well as the management board as a whole has a right to challenge a resolution of shareholders' meeting which infringes on the law or company's articles or which is detrimental to the company's interest. Moreover, in cases determined by the CCC 2000, the management board is obliged to obtain shareholders' approval before implementing certain business operations; *inter alia* a shareholders' resolution is required for disposal or lease or creating usufruct with regard to the business enterprise (understood as a aggregate of organized assets), and for the acquisition and disposal of any immovable property or perpetual usufruct right unless the company's articles provide otherwise (Art. 228).[72] Disposing of a right or incurring an obligation amounting in value to not less than twice of the share capital also requires shareholders' approval unless the articles provide otherwise (Art. 230).[73]

2. Joint-stock Company

a) Two-Tier Board as the Manifestation of the Path of Dependence

The internal structure of the Polish joint-stock company is traditionally based on the two-tier ("dual") board system of German origin with two obligatory boards – management board and supervisory board. Those two bodies have different tasks and are made up of different persons. The two-tier model was already provided for in the first Polish joint-stock regulation of 1928 as well as in its successor, the Commercial Code of 1934 which was "revived" in 1990 after the political and economic turnabout.[74]

---

[72] The consent of shareholders may be granted before the company makes a declaration of intention or thereafter, however, no later than two months from the date when the company made the declaration. Lack of shareholders' approval makes the act performed by the management board a nullity in law. See Art. 17 sec. 1 and 2.

[73] Article 230 last sentence excludes the application of Art. 17 sec. 1. Therefore, the lack of shareholders' resolution does not lead in this case to the performed by the management board nullity of the act in law.

[74] See Radwan (*supra* note 2), p. 1169.

It must be stressed that the Polish regulation was modelled on pertinent German provisions contained in the *Handelsgesetzbuch* of 1897. The full-fledged regulation of two-tier board systems provided for in the *Aktiengesetz* of 1937 had no influence on the Polish legislator at that time. The core legal framework of the CC 1934 pertaining to the dual company structure was (with some modifications) transposed into the CCC 2000. Although the Codification Commission was hesitant whether maintenance of the dual system as the only available governance system was the right regulatory choice vis-à-vis granting shareholders the possibility to opt for an optimum model (be it one-tier or two-tier) to fit particular needs of a given company, at the end the conservative view prevailed.[75] Contrary to the rules applicable to domestic companies, a unitary model is available to European Companies (*Societas Europaea*) with registered office in Poland. This notwithstanding, the two-tier board model is deeply rooted in the Polish legal system and any deviation from that model – even should the law finally allow for choice in corporate self-governance– might encounter reluctance on the side of practitioners caught on the path of dependence.

b) Management Board

The management board of Polish joint-stock companies may be composed of one or more members who are appointed and dismissed by the supervisory board unless the company's articles provide otherwise. In particular the articles may grant the general meeting the power to appoint and dismiss members of the management board. Moreover, the right to appoint a specified number of managers may be granted to a specific shareholder as a personal right (Art. 354 sec. 1) or even to a third party. The term of office shall not exceed 5 years, with no restrictions on the position's renewal. (Art. 369 sec. 1). A 'staggered board' (i.e. a partial replacement of board members) may be provided for in the company's articles (Art. 369 sec. 2). In any case and regardless of the manner of appointment, the members of the management board may be dismissed or suspended directly by the general shareholders' meeting (Art. 368 sec. 4). Thus, the shareholders ultimately decide the personal composition of the management board. The position of a member of the management board remains weak vis á vis the shareholders, as any member may in principle be removed at any time and without cause (Art. 370 sec. 1)[76]. Nevertheless, shareholders may strengthen this position in the articles by restricting the possibility of

[75] See Sołtysiński [in:] Grossfeld et al. (*supra* note 5), p. 428.

[76] The dismissal shall not deprive the dismissed member of the right to raise claims related to his or her employment or any other legal relationship concerning the performance of the function of a management board (Art. 370 sec. 1 CCC second sentence).

their dismissal to important reasons (Art. 370 sec. 2). These provisions are frequently adopted by listed companies.

The management board is liable for the managing company's affairs and representing the company vis-à-vis third parties. Where the management board is composed of more than one person, all of its members have the right and duty to jointly conduct the company's affairs unless the articles provide otherwise (Art. 371 sec. 1). This means that all company matters are decided by the entire board by way of a resolution. Exceptions to the collegiality principle are allowed, but only in the articles of the company and not in the internal rules of the board. The articles may provide for an internal division of members' duties and responsibilities with respect to different fields of the company's activity that may be based either on functional or geographical criteria.

The management board is autonomous within the scope of its tasks as determined by law and in the articles. Members of the management board are bound to act in the best interest of the company.[77] A doctrinal and practical controversy concerning the extent of managers' autonomy arose on the ground of regulation of Art. 375, according to which the relationship to the company of members of the management board are subject to the restrictions set forth in the law, the articles, the by-laws of the management board and resolutions of the supervisory board and the general meeting. A new Art. 375^1 was introduced in 2003. It states explicitly that neither the general meeting nor the supervisory board may give binding instructions to the management board as to the running of the company's affairs. Thus, the allocation of powers among corporate bodies as provided for in the CCC 2000 and the company's articles has to be respected by all company's constituencies who should act accordingly. However, it needs to be emphasised, that the corporate practice of many Polish joint-stock companies (including listed companies) deviates from this statutory pattern. Due to the widespread existing ownership structure dominated by concentrated shareholding in Polish companies, members of the management board are *de facto* strongly dependent on the majority shareholder (usually another legal entity, mostly controlling company or a "head" of a corporate group). Ultimately the directors' role tends to be reduced to implementation of the group strategy defined at the parent company level. This factual dependence is fostered by the liberal rules on directors' removal (Art. 370 sec. 1) discussed above. This opens the Polish lawmaker to criticism for inconsistency: on the one hand the autonomy of management board members is formally provided for in the law, while on the other hand, the law gives shareholders the possibility of removing a director at any time, thus giving shareholders a Damocles sword to hang over

[77] See *supra*, sub VI.2.b.

the managers' fate. The liberal approach to directors' removal was first borrowed by the legislator of the Polish CC 1934 from the German Commercial Code of 1897, but then the paths of development diverged: while in Germany the reform of 1937 (upheld in 1965) brought limitations to the possibility of directors' removal at any time (see sec. 84 (3) *Aktiengesetz*), in Poland the old approach has survived until present day.

c) General Shareholders' Meeting

The position of shareholders in the company structure under the CCC 2000 reflects the traditional continental approach to the general meeting providing them with a power to decide a long list of issues. That list embraces significant corporate actions and "organic" (structural) changes, such as: changes to the company's articles, mergers, divisions, transformation in another legal form of company or partnership, voluntary dissolution. What is more, shareholders' approval by a qualified majority is also required to effectuate minority squeeze-out from a non-listed company (Art. 418)[78], exclusion of shareholders' pre-emptive rights (Art. 432 sec. 2)[79] and delisting (Art. 91 (4) of the Act of 29 July 2005 on *Public Offering (...) and Public Companies*).[80] The ordinary general meeting is authorized *inter alia* to approve the annual report of the management board and to dispose of financial resources of the company, i.e. about the distribution of profit or coverage the losses (Art. 395 sec. 1). Any instructions by the management board or supervisory board concerning profit distribution are not binding on the shareholders.

A further list of the statutory powers of the general meeting is contained in Art. 393, the wording of which reads as follows: "In addition to other matters identified in this Section or in the company articles, a resolution of the general meeting shall be required for: (1) examination and approval of the management board's report on the company's activities and of financial statements for the preceding financial year, likewise for granting a vote of acceptance to members of company bodies confirming the discharge of their duties; (2) taking decisions in respect of claims for making good on damage suffered through the formation of the company or exercise of management or supervision; (3) transfer or lease of an enterprise or an organized part thereof and establishment of a limited right in rem thereon; (4) acquisition and transfer of an immovable property, perpetual usufruct, or share in immovable property, except where company articles provide otherwise; (5) making an issue of convertible bonds or bonds with

[78] Qualified majority of 95% required.
[79] Qualified majority of 80% required.
[80] Qualified majority of 80% required.

the priority warrant and an issue of the subscription warrants referred to in Article 453, paragraph 2; (6) acquisition of own shares in the circumstances referred to in Article 362, paragraph 1, subparagraph 2 and authorization for their acquisition in the circumstances referred to in Article 362, paragraph 1, subparagraph 8; (7) conclusion of a contract referred to in Article 7.[81]" This list may be added to in the company's articles. The attention of the comparative corporate lawyer should be particularly drawn to the provisions empowering shareholders with respect to decisions over the business enterprise meaning the entirety of organized corporate assets or a part thereof (Art. 393 No. 3).[82] At first glance, this provision resembles the famous *Holzmüller* doctrine developed and maintained by the German Supreme Federal Court (BGH)[83]. However the seemingly corresponding role of the CCC 2000 has been rather narrowly interpreted by the Polish Supreme Court to exclude share deals (meaning disposal of shares of a subsidiary through which business activity was effectively conducted) outside its scope of application.[84] According to the Court that kind of mediatisation of ownership suffices to remove the shareholders' approval requirement. This judgment may come as a surprise for a lawyer accustomed to the functional approach to the judicial interpretation of law. The Polish Supreme Court in contrast, is rather reluctant to apply law in such a creative manner, preferring instead to give preference to formal interpretation based on the wording of the legal provisions.

As mentioned above, a company's articles may include additional items in the list of matters requiring shareholders' approval so as to allow share-

---

[81] Such a contract under Art. 7 resembles the German "*Beherrschungs- und Gewinnabführungsvertrag*".

[82] This resolution shall be adopted by a qualified majority of three-fourths of votes, Art. 415 sec. 1 CCC.

[83] In its 1982 *Holzmüller* decision (BGHZ 83 at p. 122), the Federal Supreme Court established that the general meeting of a stock corporation holds an implied power to take managerial decisions which substantially affect shareholders' rights (in that case, the disposal of a business which amounted to 80% of the company's assets). In two recent decisions the Federal Supreme Court clarified the former Holzmueller judgement as follows: (a) the approval of the shareholders meeting shall only be required in exceptional cases which constitute a fundamental structural change equivalent to an amendment to the company's articles of association, (b) the disposal of less than 50% of the assets involved does not trigger the requirement of shareholders' approval, (c) whenever shareholders' approval is required, the resolution must be passed with a qualified majority of 75% (Gelatine – II ZR 154/02, 155/02).

[84] See judgment of the Supreme Court of 23 October 2003 (V CK 411/02, OSNC 2004/12 item 197) – the ruling came out with respect to a limited liability company, but may be equally applied to a joint-stock company, where the powers of general meeting as laid down in the CCC 2000 are nearly identical to those conferred upon the shareholders of a limited company.

holders to adopt a set of tailor-made articles fitting the needs of a particular company and to further curb managerial discretion. However, if the management board infringes on an internal restriction laid down in the articles (e.g. concludes a specific transaction without a prior consent of shareholders), the transaction remains valid vis-à-vis third parties. The violation of the articles by the board entails civil liability of board members to the company (Art. 17 sec. 3).

d) Supervisory Board

The supervisory board is an obligatory body for all joint-stock companies. The board must be composed of at least three members, and in listed companies – of at least five members to be appointed and dismissed by the general meeting (Art. 385 sec. 1). The company articles may provide for a different manner for appointing and dismissing members of the supervisory board (Art. 385 sec. 2). The right to appoint or dismiss a specified number of the members of supervisory board may be conferred upon an individual shareholder (Art. 354 sec. 1), upon a holder of a specified class of registered shares (preference shares, Art. 351) or even upon a third party. The statutory right of employees to elect a specified number of supervisory board members (workers' codetermination) is provided for in the Polish law to a limited extent. This right exists only with respect to companies resulting from the transformation of a former state enterprise[85] and allows the workers to elect two-fifth of the supervisory board members directly.

As a matter of legal policy there is an apparent trade-off between minority protection and employee protection by means of codetermination rights. As Polish law, as a rule, does not provide for workers' participation, minority interests in the board can be accommodated. With regard to the election of supervisory board members, CCC 2000 provides minority shareholders with a right to require that representatives are appointed by way of the "group vote" (Art. 385 sec. 3–9). "Group vote" is a defined election technique enabling minority shareholders to influence the composition of the supervisory board. With regard to its function, the "group vote" resembles what is known as "cumulative voting" provided for in jurisdictions of some US-American states. Yet in fact the "group vote" represents an autonomous development of Polish corporate law already contained in the CC 1934 and retained in a slightly modified way in the CCC

[85] See Articles 12–16 of the Act of 30 August 1996 on Commercialisation and Privatisation, Journal of Laws (*Dziennik Ustaw*) of 2002, No. 171, item 1397 as amended.

2000. At the request of shareholders representing at least *one-fifth*[86] of share capital, members of the supervisory board shall be elected at the next general meeting by a vote in separate groups, even if the articles of the company provide otherwise (Art. 385 sec. 3)[87]. However, holding one-fifth of the share capital might prove insufficient to effectuate the appointment of a given shareholder's representative in the board. The amount of shares allowing for this kind of electing group are determined by dividing the total number of shares represented at a given general meeting by the total number of supervisory board members[88] of that company.[89] Shareholders electing their members by means of a group vote are automatically excluded from the election process outside that group (Art. 385 sec. 5). Thus, the minimum amount of shares required to form an election group is dependent on two variables: the amount of shares represented at a given general meeting, and on the total number of board members. The higher the number of board members, the fewer shares are needed to form an election group. Each election group is entitled to elect as many board members, as the number of times the amount of shares held by that group exceeds the minimum amount determined in the way described above. The groups may also merge with one another in order to elect more members of the supervisory board.[90] The number of groups does not need to match the number of board members to be elected; only one group need be formed (Art. 385 sec. 7). The seats on the board which have not be filled by an electing group shall be filled by way of voting with the participation of all shareholders who did not cast their votes in a separate group (Art. 385 sec. 5). Upon the election of at least one supervisory board member by group vote, the terms of office of all existing members expire automatically (Art. 385 sec. 8). Moreover, the CCC 2000 grants each electing group

---

[86] The fraction of share capital which is necessary to trigger the whole procedure (20%) is high in comparison to fractions required by law with regard to other minority rights (5% or 10%, see, e.g., Art. 223, 400, 401).

[87] However, where a person appointed by persons (e.g. employees of the company) or an entity specified in a separate Act sits on the supervisory board, only the remaining members thereof shall be subject to election (Art. 385 sec. 4).

[88] Where the company's articles determine only the minimum or the minimum and maximum number of board members, the general meeting should first adopt a resolution determining the precise amount of board members to be elected.

[89] E.g. if the total number of board members under the articles of association is three persons, the minimum threshold enabling the group to elect a board member amounts to 33%, In a board composed of 4 members, the threshold is 25%, where the aforementioned percentages refer not to the whole share capital but to the share capital present or represented at the general meeting.

[90] See for details Szwaja, J [in:] Sołtysiński, S./Szajkowski, A./Szumański, A./ Szwaja, J., *Kodeks spółek handlowych. Komentarz*, Volume III, Warszawa 2008, pp. 782 et seq.

an additional, far reaching right to delegate one of the board members elected by that group to individually and permanently perform supervisory tasks (Art. 390 sec. 2). Members so delegated have the right to attend meetings of the management board in an advisory capacity. These minority rights are criticised in Polish legal doctrine,[91] which points out that the participation of minority representatives in the supervisory board may have a negative effect on the corporate governance of the company, endangering the internal consistency of the board and triggering conflicts among its members. The minority, equipped with the right to dispatch their representative to the management board, is capable of disrupting the operational capacity of management and discouraging executive directors from discussing openly company's affairs. Proposals have been made to repeal the relevant provision[92] or to downgrade its nature to a default rule subject to a discretional opt-out in the company's articles.[93]

The main task of the supervisory board is to exercise permanent supervision over the company's activities in all aspects of its business (Art. 382 sec. 1). In fact, the supervisory board does not act permanently but periodically, through meetings which are convened when the need arises, but not less than three times in a financial year (Art. 389 sec. 3). Special duties of the supervisory board include evaluation of management board annual reports (financial reports and reports on the operations of the company) to assess compliance with the financial data, documents and the facts. Supervisory boards should also give an opinion on management board proposals concerning distribution of profits or coverage of losses. In order to perform its duties, the supervisory board may inspect all company documents, request reports and explanations from the management board and employees as well as review assets and liabilities of the company (Art. 382 sec. 3). In principle, the supervisory board shall perform its duties collectively; individual members may however be delegated to perform specific supervisory tasks (Art. 390 sec. 1). The company's articles may extend the powers of the supervisory board, and, in particular, provide for the obligation of the management board to obtain the consent of the supervisory board prior to undertaking the actions specified in the company's articles (Art. 384 sec. 1). Contrary to the regulation provided for in other legal systems (e.g. German law), the supervisory board itself is not entitled to determine a list of corporate actions that should require its prior consent. Should the supervisory board refuse to consent to a specific corporate action, the management

---

[91] Opalski, A. *Rada nadzorcza w spółce akcyjnej*, Warszawa 2006, p. 91.

[92] Opalski (previous note), p. 514.

[93] Bąk, J./Oplustil, K., *Ius cogens w prawie spółki akcyjnej – analiza prawnoporównawcza*, Quarterly for the Entire Commercial, Insolvency and Capital Market Law (HUK) 2007, No. 2, at p. 184.

board may request the general shareholders' meeting to overrule the supervisory board so as to approve the action notwithstanding the supervisory board's refusal (Art. 384 sec. 2).

Problems and shortcomings of the Polish two-tier governance system[94] correspond with general findings and assessments made with regard to this model in other countries.[95] The list of shortcomings includes *inter alia;* information asymmetry to the disadvantage of the supervisory board and weak information flow between the management board and the supervisory board; insufficient commitment on the part of the supervisory board members with respect to performing their supervisory duties as well as inadequate knowledge and experience needed to assure effective monitoring; and weak communication and insufficient co-operation between the supervisory board and external auditors. Members of the supervisory board have limited independent access to information and need to rely on the management board as a source. This increases the risk of manipulation and filtering of information by the managers. Further aggravating this situation, the CCC 2000 lacks any regulation which would explicitly provide for a management board duty to periodically inform the supervisory board about the entrepreneurial planning and its implementation (see, e.g. sec. 90 (1) German *Aktiengesetz*). Thus, in many cases it is up to the management board to decide when and what information shall be given to the supervisory board. Also strict adherence to the collegiality principle may be detrimental for the efficiency of supervision as it may limit the board's (re)actions and responses to negative developments in the company's affairs. The CCC 2000 does not empower individual supervisory board members to request that managers present certain information or reports be presented to the supervisory board at its next meeting (unlike the German *Aktiengesetz* – see sec. 90 (3) AktG). Another omission is the CCC 2000 silence on board committees and co-operation between supervisory board and external auditors.[96] Thus, one may say, for Polish law, a review similar

---

[94] Empirical evidence on the functioning of supervisory boards in Polish joint-stock companies is delivered in the study by Deloitte, PID&Rzeczpospolita, *Współczesna Rada Nadzorcza 2007*, available at: <www.deloitte.com/pl>.

[95] For Germany see: Hopt, K.J. *The German Two-Tier Board: Experience, Theories, Reforms* [in:] Hopt, K.J./Kanda, H./Roe, M.J./Wymeersch E. (eds.) *Comparative Corporate Governance*, Oxford 1998, p. 227 et seq.

[96] Art. 86 of the Act of 29 May 2009 on statutory auditors provides for an obligation to create an audit committee in the supervisory board of companies being the so called "public-interest entities" as well as regulates the tasks of this committee. However, if the supervisory board is composed of no more than 5 members (which is the minimum number of supervisory board members in a public company, Art. 385 sec. 1 CCC) formation of an audit committee is not necessary and its tasks may be vested with the board as a whole. The regulation of Art. 86 of the Act of 29 May 2009 constitutes imple-

to that of the German *Aktiengesetz*reform of 1998 (KonTraG) is needed and still outstanding.

VII. Directors' Duties

1. Standard of Care and Diligence

CCC 2000 provides the standard of care and due diligence to be applied by corporate officers (members of management board and supervisory board, liquidators) – Art. 293, Art. 483. These persons, while performing their duties, should act with due care appropriate to their professional position.[97] The provision recapitulates the normative contents of Art. 355 sec. 2 Civil Code, setting a higher standard against which the conduct of a company's representative is measured – a raising of the regular benchmark applied to ordinary non-business individuals. Thus, directors are expected to possess knowledge and experience as well as to apply the care of a businessperson as determined by the size and profile of the company.[98] To illustrate this approach, e.g., members of the management board of a large bank or insurance company should have a relatively higher degree of knowledge, prudence and good judgment as compared with the directors of ordinary business corporation. Even mere acceptance of the appointment by person lacking qualifications required to duly perform the duties of the director might be seen as violation of standard of care by the acceptor.[99] According to the case law, the observance of the standard of care includes "the anticipation of the results of planned actions, the fulfilment of all current and legal measures in order to properly fulfil managerial duties as well as the preservation of forethought, diligence and prudence needed to achieve objectives that are in line with the interest of the company".[100]

---

mentation of Art. 41 of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

[97] The CC 1934 referred to the "care of a diligent merchant" ("*staranność sumiennego kupca*"). This was the Polish equivalent of the German notion of "*Sorgfalt eines ordentlichen Kaufmanns*".

[98] See with regard to details: Okolski, J./Modrzejewski, J./Gasiński, L. *Odpowiedzialność członków zarządu w spółkach kapitałowych – miernik staranności* [in:] *Prawo prywatne czasu przemian. Księga pamiątkowa dedykowana Profesorowi Stanisławowi Sołtysińskiemu*, Poznań 2005, p. 496; Cierpiał, R. *Vorstandshaftung in polnischen Kapitalgesellschaften* [in:] Kalss S. (ed.) *Vorstandshaftung in 15 europäischen Ländern*, Wien 2005, p. 662.

[99] Okolski et al. (previous note), p. 501; Dziurzyński, T. [in:] Dziurzyński, T./ Fenichel, Z./Honzatko, M. *Kodeks handlowy. Komentarz*, Łódź 1995, p. 322.

[100] Judgment of the Court of Appeal in Katowice of 5 November 1998, I Aca 322/98. See also judgment of Supreme Court of 17 August 1998, III CRN 77/93.

2. Duty of Loyalty and Conflicts of Interest

Polish company law is silent on the duty of loyalty of corporate officers. However, the existence of this duty is generally accepted in jurisprudence as well as in legal doctrine. This general rule with regard to management board members of listed companies was explicitly expressed in the Best Practices Codes of 2002 and 2005. According to the rule No. 35, "a management board member should display full loyalty towards the company and avoid actions which could lead to implementing exclusively their own material interest. If a management board member receives information on the possibility of making an investment or another advantageous transaction concerning the objects of the company, she or he should present such information immediately to the management board for the purpose of considering the possibility of the company taking advantage of it. Such information may be used by a management board member or be passed over to a third party only upon consent of the management board and only when this does not infringe the company's interest."[101] This rule reflects the famous corporate opportunity doctrine developed and practised in the Anglo-Saxon, and German jurisprudence. Unfortunately that rule has been omitted from the current version of Best Practices Code of 2007. According to another provision of the Code of 2005, "in transactions with shareholders and other persons whose interests have impact on the interest of the company, the management board should act with utmost care to ensure that the transactions are at arms' length"[102] (rule No. 34).

The duty of loyalty may be regarded as an immanent element of the fiduciary relationship between the company and its officers. The duty of loyalty correlates to a large extent with the business discretion granted to them. The existence of such a duty may be derived from a number of CCC 2000 regulations providing more detailed duties of management board members. For instance managers are subject to comprehensive statutory non-competition obligation. They may not engage in any competing business or participate in any rival entity, except with consent from the company. This prohibition includes acting as a partner in a partnership or civil partnership, and appointment as a member of the authorities of a rival company. Moreover, the prohibition also applies to participation in a rival company if a member of the management board holds at least ten per cent of shares in the company or has the right to appoint at least one member of the management board of that company (Art. 211 sec. 1, Art. 380 sec. 1)[103]. Unless the company's articles provide otherwise, consent is

---

[101] Excerpt from the official translation by the Warsaw Stock Exchange.

[102] *Supra*.

[103] With regard to the limited liability company, the same regulation is contained in Art. 211 CCC.

granted by the body empowered to appoint the management board (Art. 211 sec. 2, Art. 380 sec. 2).

In the event of a conflict of interest between the company and a management board member, or the member's spouse, relatives or in-laws within the second degree and persons with whom the member has a personal relationship, the management board member shall abstain from participating in deciding such matters and may request that this be recorded in the minutes (Art. 209, Art. 377). With regard to members of the supervisory board a similar provision is contained in soft law, i.e. in the Best Practices Code of 2007 (part III, No. 4). Moreover, the CCC 2000 provides for special treatment for loans, credit and similar agreements concluded by the company with or for the benefit of, *inter alia*, a member of the management board or supervisory board (Art. 15 sec. 1). Conclusion of such an agreement requires the consent of the shareholders' meeting. Where conclusion of this agreement involves a dependent company and a member of the management board of the dominant company, the consent of the shareholders' meeting of the dominant company is required (Art. 15 sec. 2).

3. Business Judgment Rule

The business judgment rule as developed by US courts is a presumption ("safe harbour") that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.[104] Unlike in Germany (see sec. 93 (1) *Aktiengesetz*[105]), Polish law does not codify the business judgment rule. Absent a normative ground, it cannot be presumed that the director, while conducting company's affairs, met appropriate standards of a due care and diligence. On the contrary, whenever a suit against the director is filed, the burden of proof in the legal proceedings lies with the defendant, i.e. the incriminated member of the management board or the supervisory board. According to a ruling of the Polish Supreme Court, a reference to an economic risk cannot exculpate the manager, when the damage inflicted upon the company was the result of careless management.[106] On the other hand, Polish doctrine and the courts acknowledge the existence of a large degree of managerial discretion including the power to accept certain level of risk inherent to a given business activity, provided that they observe proper standards of care and

---

[104] Aronson v. Lewis, 473A.2d, 805 (at 812) (Del. 1984). See also Bainbridge, S. Corporation Law and Economics, New York 2002, p. 269.

[105] Introduced with the UMAG-reform of 2005.

[106] Judgment of 9 May 2000, IV CKN 117/00.

loyalty towards the company.[107] This view was reflected in rule No. 33 of the Best Practices Code 2002 and 2005: "While making decisions on corporate issues, members of the management board should act within the limits of justified economic risk, i.e. after consideration of all information, analyses and opinions, which, in the reasonable opinion of the management board, should be taken into account in a given case in view of the company's interest"[108]. Unfortunately, this provision has not been transferred to the new Best Practices Code 2007.

4. Directors' Liability and Shareholders' Remedies

The main legal basis for corporate officers' liability may be found in Art. 483 (for joint-stock companies) and 293 (for limited companies). Under this regime a member of the management board, the supervisory board, or a liquidator is liable to the company for any damage inflicted through negligence or an action which is contrary to the provisions of law or the company's articles, unless no fault is attributable to this person. In legal proceedings, the plaintiff (i.e. the company or a shareholder acting on its behalf, see below) has to prove: firstly, the extent of the damage inflicted upon the company, secondly, the contributing behaviour of the corporate officer infringing the law or company's articles, and thirdly, the causal link between the damage and officer's misbehaviour. The burden of proof for the observance of the duty of due care rests with the defendant, i.e. the incriminated officer.[109] Filing a suit against the officer requires prior approval by the shareholders' meeting (Art. 228 No. 2, Art. 393 No. 2). Thus, the decision to litigate is ultimately up to the shareholders as a group. In judicial proceedings against a member of the management board, the company is represented by the supervisory board or by a special attorney appointed by the general meeting (Art. 379 sec. 1). If the company fails to bring an action for redressing damage within one year from the disclosure of the injurious act, each shareholder, or a person otherwise entitled to participate in the profit or in the distribution of company's assets (e.g. holders of bonds giving the right of participation in company profit), may bring a suit on behalf of the company (*actio pro socio*, derivative suit – Art. 486 see also below in this chapter).

Polish law gives preference to a democratic approach to shareholder rights, the legislator consciously rejected the use of quora and thresholds

---

[107] See judgment of Supreme Court of 26 January 2000, I PKN 482/99; Okolski et al. (*supra* note 98), p. 503; Okolski, J./Wajda, D. *Odpowiedzialność członków zarządu spółek kapitałowych*, PPH 2007, No. 2, p. 12.

[108] Excerpt from the official translation by the Warsaw Stock Exchange.

[109] See, with regards to details, Szczęsny, R. *Odpowiedzialność odszkodowawcza członków zarządu,* Prawo Spółek, 2007, No. 3, p. 22 et seq.

as means of limitation on the availability of shareholders' remedies. As a consequence, every single shareholder, regardless of share ownership, can challenge a general meeting resolution. The importance of the individual shareholder's action against the resolution is further advanced by the traditional view of shareholder democracy. According to this view, shareholders as "owners" of the company shall have decision-making powers with respect to all important transactions and operations of the company. The consequence of this assumption is the aforementioned long list of powers assigned to the general meeting by mandatory law (*inter alia*. Art. 393). Thus shareholder's involvement in the decision making process does not end with a vote, but extends to include a possible veto attempt (suit). Actions against the resolutions of shareholders' meeting as codified in Polish law are characterised by a certain dualism: an action based on violation of legal provisions (action for nullity – *powództwo o stwierdzenie nieważności*[110] – Art. 252, Art. 425) and an action based on infringement upon shareholders' rights, company articles, company interests or good faith (action for rescission, Polish: *powództwo o uchylenie*[111] – Art. 249, Art. 422). However, the resemblance to their German counterparts may be misleading. The main difference lies with the scope of application. The dividing line between these two sorts of action in Polish law appears controversial. Unlike in Germany, where the availability of the action for nullity (*Nichtigkeitsklage*) is limited to the most severe violations of mandatory law (Sec. 241 *Aktiengesetz*), in Poland, any infringement of legal provisions is grounds for a claim of nullity. One needs to bear in mind that the timeframe for this form of action may be relatively long, unlike the regular action for rescission which has a limited time of application (see Art. 424, Art. 425 sec. 2 and 3). From a policy perspective, the shift in the practical significance from a less severe action (rescission) to the more severe action (nullity) is questionable. In addition to this, legal doctrine and the judicature have acknowledged the existence of the so-called *negotium non existens* or pseudo-resolution. This opens a third way to challenge the resolution based on the rules of civil procedure (Art. 189 Code of Civil Procedure). The overall picture made up by this trinity of legal means is rather obscure, and is further aggravated by a certain ambiguity of case law and opposing views expressed by legal scholars.[112]

Another remedy vested with any individual shareholder is the derivative action (*actio pro socio* – Art. 295 for a limited liability company, Art. 486

---

[110] German: *Nichtigkeitsklage.*

[111] German: *Anfechtungsklage.*

[112] For review of different opinions in the legal doctrine and case-law see: Spyra, M. [in:] Włodyka, S. (ed.) *Prawo spółek handlowych*, Volume 2B, Warszawa 2007, p. 487 et seq.

for a joint-stock company).[113] This form of action is available if the company fails to bring an action for redressing damage within one year from the disclosure of the injurious act. In this case any shareholder and, in a joint-stock company, any person entitled to participate in profit or in the distribution of assets (e.g. holders of bonds giving the right of participation in company profit), may bring a suit on behalf of the company.[114] Where a derivative action has been brought, those liable to redress the damage may not invoke the resolution of a shareholder meeting acknowledging their fulfilment of duties or a waiver by the company of its claim for damages (Art. 296 and Art. 487). The plaintiff must prove abuse on the part of corporate officer, the damage inflicted and a causal relation between the abuse and the damage to the company.[115] It should be noted that the significance of derivative action in Polish corporate practice is rather minimal. That is due to a couple of reasons, first, the payoff for a suing shareholder is likely to be negative in the majority of cases, second, information asymmetry makes it difficult for the shareholder to effectively bear the burden of proof. There is no favourable cost regime in place to facilitate the use of derivative action nor is there a system of presumptions to mitigate the aforementioned information asymmetry. Therefore, there is a case for reforming the current Polish derivative action regulation in order to improve its efficiency as a means of investor protection.

The efficiency of shareholders' remedies and the conscious pursuit of their overall investment strategy relies heavily on access to information. In this context there seems to be an apparent deficit in the regulatory framework on shareholder's information rights in a limited liability company, namely a shareholder's individual right to control company's affairs (Art. 212) may be excluded if the company establishes a supervisory board or auditors committee (Art. 213 sec. 3). This might lead to the establishment of 'pseudo' board solely to frustrate shareholder access to information.[116] However, the minority in a limited liability company may file a motion to appoint a special purpose auditor (Art. 223). For this motion to

---

[113] See the monographic study of Bilewska, K. *Dochodzenie roszczeń spółki kapitałowej w przez jej wspólników (actio pro socio)*, Warszawa 2008.

[114] In order to prevent an abuse of the derivative action, CCC provides that, at the defendant's request, the court may order bail to be provided as a security for damage the defendant stands to suffer (Art. 486 sec. 2). Moreover, where the action has proved groundless and the plaintiff, by bringing the action, acted in ill faith or was flagrantly negligent, the plaintiff shall make good on the damage wrought upon the defendant (Art. 486 sec. 4).

[115] See judgment of Supreme Court of 9 February 2006, V CK 128/05.

[116] See Bilewska, K. *The right to information – a basic shareholder's right*, Quarterly for the Entire Commercial, Insolvency and Capital Market Law (HUK) 2008, No. 4, p. 455.

be effective, a quorum requirement of one-tenth of the share capital needs to be met. A corresponding right is provided for shareholders of public (listed) companies whenever they reach a threshold of 5% of total votes (Art. 84–85 *Act on Public Offering (...) and Public Companies*). It follows, that for a joint-stock, non-listed company there is no such minority right protection, which comes at surprise and might be seen as a regulatory gap.

Another gap, or in fact a conscious omission, which has resulted in a regulatory vacuum is found in addressing the problem of groups of companies. In leaving this problem outside of the CCC 2000, the legislator left the issue up to the courts, but there is no clear line of case law emerging. Although the CCC contains a few provisions referring to the notion of affiliated companies (Art. 4 sec. 1 No. 4, 5, Art. 6, Art. 7), those provisions are effectively silent on minority protection other than some fragmentary information rights limited to the mere existence of the dependency relationship.[117] Currently there is a discussion regarding whether and how to tackle as yet unsolved issues through legislative intervention.[118]

A final word is warranted on the recent act implementing the Shareholders Rights' Directive (2007/36/EC)[119] into the Polish legal system, which brought a selective upgrade of shareholders' rights in non-listed companies along with the transposition of rules mandated by the Directive. This includes the power to effect a convocation of general meeting, the right to put items on the agenda of the forthcoming meeting and the right to table draft resolutions.[120]

VIII. Corporate Governance Code and Enforcement

1. Background and Earlier Developments

The history of the Corporate Governance Codes ("Best Practices Codes") in Poland began in 2002, when the first version of the Code of "Best Prac-

---

[117] Sołtysiński, S./Szumański, A. *Shareholder and Creditor Protection in Company Groups under Polish Law*, EBOR 2 (2001), p. 255; Szumański, A. *Ograniczona regulacja prawa holdingowego (prawa grup spółek) w kodeksie spółek handlowych*, PiP 2001, No. 3, p. 20.

[118] Romanowski, M. *W sprawie potrzeby nowej regulacji prawa grup kapitałowych w Polsce*, PPH 2008, No. 7, p. 4; Romanowski, M. *Wnioski dla prawa polskiego wynikające z uregulowań prawa grup kapitałowych w wybranych systemach prawnych UE, Japonii i USA*, Studia Prawa Prywatnego 2008, No. 2(9), p. 4.

[119] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, Official Journal of the EU of 14 July 2007, L 184/17.

[120] The Act implementing the Shareholders Rights' Directive into the CCC was adopted on 5 December 2008 and comes into force on 3 August 2009.

tices in Public Companies" was adopted by the Supervisory Board of the WSE.[121] This Best Practices Code (as well as its amended version of 2005) was drawn up by the Best Practices Committee, composed of academics, representatives of capital market institutions (e.g. Securities and Exchange Commission, WSE), law firms and business organizations (Polish Confederation of Private Employers). According to the preamble of the Code, "best practices constitute a set of detailed rules of conduct addressed to both authorities of companies and members of such authorities, as well as to majority and minority shareholders. This set of best practices, established for the needs of the Polish capital market, presents core corporate governance standards for a public joint-stock company." Upon consultation with market participants the Best Practices Code was formally adopted by the Supervisory Board of the WSE. At the same time, the "comply or explain"-principle was introduced into the WSE Listing Rules according to which every public company was obliged to declare in its annual statement which rules of the Code were complied with and which were not. In the latter case, the company had to give reasons for non-observance of a given rule. The statement had to be passed to the WSE and to be published. Moreover, companies were obliged to promptly disclose any occurrence which constituted an *ex post* violation of a given rule.

2. The Best Practices Code of 2007

a) Underlying Idea

In 2007 the new "Best Practices Code" was drawn up from scratch and (after consultations with market participants) adopted by the Supervisory Board of WSE acting on the basis of the authorization contained in the WSE Listing Rules.[122] Unlike its predecessors of 2002 and 2005, the current Code does not represent the work of a corporate governance expert group, but is a document drawn up within the Warsaw Stock Exchange, without naming its authors.[123] The "Code of Best Practices for WSE Listed Companies" ("*Dobre Praktyki Spółek Notowanych na GPW*") is exclu-

---

[121] See Sołtysiński (*supra* note 3), p. 302 et seq.

[122] According to sec. 29 (1) WSE Rules, the Exchange Supervisory Board, on application to the Exchange Management Board, may resolve the rules of corporate governance for joint-stock companies that are issuers of shares, convertible bonds or bonds with priority rights admitted to exchange trading. English version of the WSE-Rules is available on the website: <www.gpw.pl/gpw.asp?cel=e_ogieldzie&k=7&i=/regulacje/opis&sky=1>.

[123] English version of the Code as well as another data about corporate governance of Polish companies are available on the website: <www.corp-gov.pgw.pl>.

sively addressed to companies listed on regulated market.[124] According to its preamble, the Code is to enhance the transparency of listed companies, improve the quality of communication between companies and investors, and strengthen the protection of shareholders' rights (including those not regulated by legislation). Burdens outweighing market benefits should not be imposed on listed companies. The Code of Best Practice therefore only addresses those areas where its application may have a positive impact on the market valuation of companies, thus reducing the cost of capital. This approach has been rightly criticised in Polish legal doctrine for being too strongly focused on procedural ("technical") rules of corporate governance and neglecting the introduction and promotion of general guidance (standards of conduct) for shareholders and company organs, such as the loyalty principle, corporate opportunity doctrine or business judgment rule.[125] In May 2010 the Code was reviewed and amended in order to adjust its "soft" regulation to the latest amendments of the CCC as well as to the current trends in corporate governance.

b) Structure

The Code comprises four sections. The rules defined in section I are recommendations which, according to the preamble, "embody trends concerning adequate levels of internal relations within listed companies, as well as their relationship to the business environment". The recommendations address various issues such as the need for a transparent and effective information policy to be pursued by companies (including on-line broadcasts of general meetings over the Internet), directors' remuneration, personal and professional qualifications for supervisory board members. Sections II, III, IV contain sets of Best Practices for management board members, for supervisory board members and for shareholders respectively.

c) Rules Pertaining to the Management Board

The Best Practices for management boards of listed companies open with an extensive list of information and documents to be made available on the company's website which, as of 1 January 2009 shall also be published in English. Another rule obliges the management board to request a prior approval of a significant corporate transactions (agreements) pursued with a related entity from the supervisory board. Particularly important is the

---

[124] For small companies listed on the Alternative Trading Market "NewConnect" a simplified version of the "Best Practices Code" was adopted by the WSE Board in December 2008.

[125] See critical review of the new Codes by: Opalski, A. *Nowe Dobre Praktyki w spółkach publicznych*, PPH 2008, No. 3, p. 14.

rule providing for the standard of conduct of a manager in situations in which conflicts of interests have arisen or may arise (notification of a conflict to the management board and refraining from taking part in the discussion and from voting).

d) Best Practices of the Supervisory Board

The Best Practices of supervisory board aim at activating this corporate organ and strengthening its role in internal corporate governance of listed companies. In addition to its responsibilities as laid down in legal provisions, the supervisory board must prepare and present to the ordinary general meeting a brief annual assessment of the company's standing (including evaluation of the internal control system and of the risk management system) as well as a self evaluation report. Moreover, shareholders are given the supervisory board's opinion on issues to be voted on at the general meeting. Most controversies arose from the issue of independent supervisory board members.[126] Under the Best Practices Code 2002 at least half of supervisory board members must be independent members.[127] This far-reaching rule was not compatible with the main feature of Polish corporate governance system, characterised by the prevalence of consolidated ownership where controlling shareholders extend their influence via the supervisory board. Therefore an overwhelming majority of Polish companies declared non-compliance with that rule. As a result, an attempt to transplant the Anglo-Saxon concept of independent directors into the Polish was a partial failure. Thus the amended version of the Code of 2005 provided for a more flexible rule according to which in companies where the majority shareholder holds more than 50% of the total votes, the supervisory board shall consist of at least two independent members. Furthermore, both versions of the Code granted independent members special veto rights with regard to some resolutions of the supervisory board (i.e. resolutions approving related party transactions). In fact, this amendment proved to have only a limited influence on the acceptance of the rule by the companies. Current "Best Practices" require participation of at least two independent members in the supervisory board regardless of the ownership structure of a company. As to the independence criteria, the Code expressly refers to Annex II of the Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. Over

[126] See Oplustil, K. *Niezależni członkowie rady nadzorczej (administrującej) jako instrument wzmocnienia nadzoru korporacyjnego w spółkach publicznych* [in:] Cejmer, M./Napierała, J./Sójka, T.(eds.), *Europejskie prawo spółek*, Volume III, *Corporate Governance*, Wolters Kluwer, Kraków 2006, pp. 363 et seq.

[127] Detailed criteria of independence were to be laid down in company's articles.

and above the criteria as laid down in Annex II, the Code 2007 prescribes two additional requirements: employment in the company or in an associated company as well as an actual and significant relationship with any shareholder who has the right to exercise at least 5% of all votes shall be seen as precluding the independence of that member. Contrary to its predecessor, the current Code does not equip independent board members with a veto right with regard to specific operations.

e) Board Committees

Another controversial corporate governance issue is that of board committees. These committees are not common in the supervisory boards of Polish companies.[128] A plausible explanation for that finding may be seen in the relatively small size of supervisory boards in Polish joint stock companies. According to an empirical study of 2007, supervisory boards in the majority (almost 56%) of companies examined were composed of no more than six members.[129] Due to the amendment of the Code in May 2010, the regulation requiring establishment of at least an audit committee within the supervisory board was abolished, probably because the "hard law" of Art. 86 of the Act of 29 May 2009 deals with the committee, implementing Art. 41 of the 2006/43/EC Directive. The current Code provides for no regulation of board committees and, for the tasks and operations of the board committees, only refers generally to Annex I of the Commission Recommendation mentioned above. The assessment of such a "regulatory abstinence" with respect to one of the most crucial corporate governance issues must be negative. The absence of any material regulation on managers' remuneration deserves criticism as well. The Code only requires that each listed company shall have a remuneration policy with regard to members of the management and supervisory board. For details, the Code refers to the Commission Recommendation 2004/913/EC fostering an appropriate regime for the remuneration of directors of listed companies.

f) Enforcement of the Code

Enforcement of the Code relies on the "comply or explain" principle incorporated into the WSE Listing Rules. Any non-compliance with one or more rules (including recommendations of section I of the Code) must be

---

[128] According to an empirical study of structure and functioning of Polish supervisory boards (Deloitte, PID, Rzeczpospolita, *Współczesna Rada Nadzorcza 2007*, *supra* note 93, p. 11), there is no committee in the majority (59%) of examined supervisory boards and audit committee comes up only in one third of the examined boards.

[129] Deloitte, PID, Rzeczpospolita, *Współczesna Rada Nadzorcza 2007* (*supra* note 93) p. 8.

disclosed in the annual corporate governance statement ("corporate governance report", sec 29 (5) WSE Listing Rules). The range and structure of the statement is determined by sec. 91 (5) (4) of the ordinance of the Minister of Finance of 19 February 2009 regarding ad hoc and periodical disclosure duties of the securities issuers.[130] The ordinance provisions are modelled on the European regulation provided for in Art. 46a of the Directive 78/660/EEC. The statement should inform market participants which rules (including recommendations) of the Code were not complied with, and explain the circumstances and reasons for not having applied a given rule, along with explanation of how the company intends to remedy the possible negative impact of non-compliance and what steps it intends to take in order to mitigate the risk of future non-compliance. In addition to the requirements discussed above, listed companies are obliged to perform *ad hoc* reporting on permanent or incidental violation of any of the Codes' rules contained in sections II-IV. The report should be published both on the company's official website and in the manner practised by the company for disseminating its current reports. The publication becomes due as soon as the company realises that a given rule will not be complied with permanently or incidentally (sec. 29 (3) WSE Listing Rules).

Finally it must be stated that the current Polish Best Practices Code of 2007 is not legally binding. Rules of the Code are not even a part of the WSE Listing Rules. "Best Practices" can be regarded as a soft law-instrument aimed at improving corporate governance in companies listed on the WSE. The enforcement of the Code, based on the "comply or explain"-principle anchored in the WSE Listing Rules, is left to market forces, as well as to members of the companies' organs and their shareholders. In theory, compliance or non-compliance with the Best Practices Rules may influence investment decisions made, in particular by institutional investors, and thus effect share price. However, an empirical study from 2005 shows no coherent or statistically important correlation between corporate governance structure and market evaluation of Polish listed companies.[131] Formal sanctions may be imposed in cases of non-observance of the "comply or explain" mechanism, i.e. when a company fails to publish information about the violation of a rule or when it publishes untrue, misleading or incomplete information. Firstly, one of the regulatory penalties provided for in the Listing Rules (reprimand or pecuniary fine) can be imposed on the company by the WSE Management Board or the Exchange Court. Secondly, information about the breach of a given Best Practice rule can at the

---

[130] Journal of Laws (*Dziennik Ustaw*) No. 33, item 259.

[131] Aluchna M. et al., *Analiza empiryczna relacji między strukturami nadzoru korporacyjnego (corporate governance) a wskaźnikami ekonomicznymi i wyceną spółek notowanych na GPW*, available (in Polish) on the website: <www.pfcg.org.pl>.

same time constitute price-sensitive insider or current information subject to the *statutory* public disclosure obligation, violation of which is sanctioned with civil and penal liability as provided for in the capital market law. According to Art. 98 (7) of the *Act of 29 July 2005 on Public Offering (...) and Public Companies*, the issuer (i.e. company), as well as the person (e.g. management board member) who prepared or participated in the preparation of inside information are obliged to redress damage caused by public disclosure of untrue information or omission of information unless neither they nor persons for which they are responsible, can be liable for it (reversed *onus probandi* concerning standard of care).

IX. Conclusions and Outlook

The reform of Polish company law in 2000 took place at the forefront of a major wave of reforms across Europe. Consequently, the new CCC could not take the most recent developments and modernisations into account. This makes the time of the CCC enactment quite unfortunate. Today's structure of CCC remains strongly rooted in the pre-war legislation preserving its major features. The pre-war Code was strongly influenced by the German model of company law, as is the current CCC. Europeanisation of Polish company law was also accomplished by borrowing from German law to a considerable extent. This was a rational step that has contributed to the coherency of the new code, given its Germanic origin. Yet with the progress of recent company law reforms in Europe triggered by the phantom of regulatory competition and based on the achievements of modern corporate finance, the concept of Polish company law is becoming outdated and merits a conceptual reworking.

In recent years following the CCC enactment, the major driving force of company law reform has been EC law resulting from the Company Law Action Plan 2003, particularly the Cross-border Mergers Directive and Shareholders Rights Directive. The current review of the law focuses on the question of whether and how to regulate groups of companies. Another issue is the modernisation of private limited company.

Contributors

Jürgen Basedow, Dr. iur., Dr. h.c., LL.M. (Harvard), Professor of Law, University of Hamburg and Director at the Max Planck Institute for Comparative and International Private Law, Hamburg (Germany)

Tania Bouzeva, PhD, Lecturer, Faculty of Law of Sofia University St. Kliment Ohridski (Bulgaria)

Radu N. Catană, Ph.D., Professor of Business Law, Babeş-Bolyai University, Cluj – Napoca (Romania)

Frederique Dahan, Dr. iur., Lead Counsel, European Bank for Reconstruction and Development, London (United Kingdom)

Tatjana Josipović, Dr. iur., Professor at the University of Zagreb, Faculty of Law (Croatia)

András Kisfaludi, Dr. iur, habil., Professor of Civil Law, Eötvös Loránd University, Civil Law Department, Budapest (Hungary)

Alexander Komarov, Dr. iur. Professor, Russian Academy of Foreign Trade, Moscow (Russian Federation)

Volodymyr Kossak, Dr. iur, Professor, Head of the Chair of Civil Law and Procedural Law of Ivan Franko National University of Lviv (Ukraine)

Rainer Kulms, Dr. iur., LL.M. (Michigan), Privatdozent, Senior Research Fellow, Max Planck Institute for Comparative and International Private Law, Hamburg (Germany)

Alexandra Makovskaya, Dr. iur., Supreme Commercial Court of the Russian Federation, Moscow (Russian Federation)

Thomas Meyer, Dr. iur., Consultant, Bremen (Germany), prior to 1 January 2010, GTZ Regional Office Belgrade (Serbia)

Dušan Nikolić, Dr. iur., Professor at the University of Novi Sad Faculty of Law (Serbia)

Michel Nussbaumer, Dr. iur, Chief Counsel, European Bank for Reconstruction and Development, London (United Kingdom)

Krzysztof Oplustil, Dr. iur., Managing Director of Centrum C-Law.org., Lecturer at the Jagiellonian University Cracow (Poland)

Jelena Perović, Dr. iur., Professor, Faculty of Economics, University of Belgrade (Serbia)

Meliha Povlakić, Dr. iur, Professor at the Faculty of Law, University of Sarajevo (Bosnia and Herzegovina)

Ionuț Rădulețu, Dr. iur., LL.M., Lawyer-linguist, Council of the European Union, Brussels (Belgium)

Arkadiusz Radwan, Practicing lawyer, Managing Director of Centrum C-Law.org. and President of the Allerhand Institute of Advanced Legal Studies, Cracow (Poland)

Christian Takoff, Dr. iur., Professor at the Sofia University St. Kliment Ohridski (Bulgaria)

Camelia Toader, Dr. iur., Professor, Judge, Court of Justice of the European Union, Luxembourg

Verica Trstenjak, Dr. iur., Professor at the Faculty of Law, Maribor, and Advocate-General at the Court of Justice of the European Union, Luxembourg

Mirko Vasiljević, PhD, Professor and Dean of the University of Belgrade Faculty of Law (Serbia)

Oleg Zaitsev, Ph.D., LL.M., Chief counsel of the Department of Private Law at the Supreme Commercial Court of the Russian Federation, Lecturer in Corporate Law at the Moscow School of Social and Economic Sciences (Russian Federation)

Multilateral Agreements and European Union Law

Multilateral Agreements

European Union Law (Secondary Legislation)

Other Materials