The Influence and Effects of EU Business Law in the Western Balkans

The Influence and Effects of EU Business Law in the Western Balkans

– Conference proceedings of the 1st EU Business Law Forum

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Content

Foreword

The Copenhagen European Council meeting in December 2002 was momentous not only for the accession of the Central and Eastern European countries, but the EU Member States opened also a wide window on the future of Western Balkans and laid down the stabilisation and association policy objectives of the European Union towards the countries of the region. The Conclusions of the meeting confirmed the status of the Western Balkan countries as potential candidates and emphasised its determination to support the efforts of these countries to move closer to the European Union. One year later, the Thessaloniki Agenda for the Western Balkans assured the full support of the EU Member States to the endeavours of the region to consolidate democracy, stability and promote economic development as well. The Agenda gave priority to further liberalisation of trade relations and urged the Western Balkan countries to accelerate the momentum of structural reforms, promote good governance and create a business environment that stimulates economic activity and foreign investment.

Today the potential candidates have a significant trade relationship with the European Union and their business environment as well as market conditions are progressively becoming more stable and transparent. At this time, Montenegro and Serbia are already under negotiation for EU membership, Republic of North Macedonia is to be planned to open the talks in 2019, but also Albania, Bosnia and Herzegovina, and Kosovo have the prospect of joining the negotiations in the future.

The accession process is enhanced also by harmonisation of the legal orders of the potential candidate countries with the framework of *acquis* of the European Union. The converging tendency of laws is specifically addressed in the approximation clauses of the Stabilisation and Association Agreements concluded by the Western Balkan countries with the European Union. The approximation clauses require the candidate countries to make their existing and future legislation gradually

compatible to the EU law and to ensure the proper implementation thereof. This make the scholarly discussion about the accession of the Western Balkan countries topical today and it was the main reason for organizing a conference at the Centre for European Studies of Faculty of Law and Political Sciences of the Széchenyi István University. The '*1st EU Business Law Forum – The Influence and Effects of EU Business Law in the Western Balkans*' was held between 15 and 16 June 2017 in Győr.

The conference was devoted to identify the relevant developments of this new enlargement process and shed light on its legal, political, economic and social implications. The first day the Forum was opened by a round-table discussion that gave the chance to explore the legal environment of business opportunities in Central Eastern European and Western Balkan countries. *András M. Horváth* (Kajtár Takács Hegymegi-Barakonyi Baker & McKenzie, Budapest) and *Csaba Pigler* (Nagy & Trócsányi, Budapest) shared their views and experiences on this topic, and the discussion was chaired by Prof. *László Milassin* (Centre for European Studies). The second day the plenary session of the conference continued with the key-note lectures. *Marko Babić* (University of Warsaw) scrutinized the transitional reforms taken place in the Balkan states, *Dragan Gajin* (Doklestic Repic & Gajin, Beograd) assessed the implementation of the EU Internal Market Law in the Western Balkan countries, and *Éva Lukács Gellérné* (ELTE Faculty of Law, Budapest) examined what challenges the free movement of persons might pose for the Western Balkan region. Subsequently the participants presented their papers in the research sessions.

This book contains twelve papers and well illustrates the variety of topics that were discussed at the conference. Readers may discover what relevance the EU business law has in accession process of the Western Balkan countries, and have insight into the national implementation and certain external aspects of EU internal market law, as well as questions related to dispute resolution models and financing issues of commercial transactions. The Forum was part of the 'Jean Monnet Module on EU Business Law' (EUBLAW) project funded by the European Commission's Erasmus+ Programme in the Period of 2016 – 2019.

Editors
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Insolvency Proceedings of Corporate Groups under the New Insolvency Regulation – Reflection and Impacts on Croatian, Bosnian and Slovenian Insolvency Regulation

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Abstract: In March 2015 the European Council and Parliament adopted the text of the new Insolvency regulation (2015/848). Unlike the previous Insolvency regulation (1346/2000), the new Regulation contains provisions related to the insolvency of group of companies (corporate groups) which members are located in various member states. Since insolvency proceedings of group of companies are recognized as a complex and very important issue to deal with, this paper will try to provide an overview of legislative solutions in the European Union, but also in three jurisdictions: Croatian, Bosnian and Slovenian, and based on that will try to define in what way (if in any) the new Insolvency regulation influences legislative solutions in chosen jurisdictions. The issue is particularly relevant in light of problems that recently affected Agrokor, the biggest Croatian retail company which has a network of companies both in Slovenia and Bosnia.

Keywords: insolvency proceedings, groups of companies, corporate groups, insolvency regulation, Regulation 2015/848

1. Introduction

In March 2015 the European Council and Parliament adopted the text of the new Insolvency Regulation (2015/848). New Insolvency Regulation introduces several legislative novelties in regulation of cross-border insolvency proceedings such as: widened scope of application to pre-insolvency and rescue proceedings, introduction of the publicly accessible registers, mandatory cooperation of insolvency practitioners of main and secondary insolvency proceedings etc. Among perhaps the most important novelty is entirely new procedure regarding insolvency proceedings of corporate groups.

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Corporate groups are modern company law phenomenon. In the modern company law, corporate groups have become the most popular and the most typical structure of international enterprises. It is generally regarded that corporate groups have crucial importance in economic development of many states and that they produce set of positive impacts on innovations, employment, economic growth etc. However, when it comes to insolvency of one or more members of same corporate group, number of problem arises such as: should we have one insolvency proceedings for whole corporate group or should we have several separate insolvency proceedings over every insolvent member belonging to the same corporate group? Should there be one insolvency estate and one insolvency practitioner for a whole group or for every member of a group? How to prevent cash flow from one member of a group to others and thus to protect creditors etc.?

These are only some basic questions to which modern insolvency law regulation should have provided an answer. Yet, there is no doubt that the issue of multinational corporate groups and their insolvencies, so far, has not been dealt sufficiently[1]. One of the reasons why insolvency proceedings of corporate groups remains internationally unregulated issue, lays in the fact that different states have different approaches and legal regulations of insolvency proceedings, which make "extremely difficult to devise an international model that will be acceptable to a wide range of countries"[2].

However, this should not be an excuse for leaving such an important legal issue mainly unregulated, particularly if we take into consideration the fact that the damages which may be imposed to the companies' creditors, contractors or other associates of the companies, are usually immense.

In the view of aforementioned, we should greet European Commission's legislative effort to deal with the problem of corporate group's insolvency in the new Insolvency Regulation.

In that sense this article primarily intends to provide an overview of the most important legislative solutions concerning insolvency proceedings of corporate groups in the new Insolvency Regulation. However, before going into that analysis it will shortly reflect on the general phenomenon and

[1] Irit Mevorach, 'Appropriate treatment of corporate groups in insolvency: a universal view' (2007) 8 (2) European Business Organization Law Review 179, 182.

[2] ibid.

types of corporate groups. Furthermore paper will also explore regulatory framework for insolvency proceedings of corporate groups in three jurisdictions Croatian, Bosnian and Slovenian. The selection of those jurisdictions is not accidental. Since all three countries are neighbouring countries and all belong to ex-Yugoslav countries they are traditionally linked with strong commercial links. Many of companies that are present on the markets of all those countries belong to the same corporate group, what consequently raises the question what would happen with the group member(s) if an insolvency proceedings is opened upon holding company in one of those countries. The issue is particularly relevant in light of problems that recently affected Agrokor, the biggest Croatian retail company which has a network of companies both in Slovenia and Bosnia and which is faced with serious financial troubles and possibly with bankruptcy[3].

2. The Phenomenon and Definition of Corporate Groups

"Groups of companies are the most important and commonly encountered business structure throughout Europe"[4], however no unified

[3] In the beginning of 2017 the Croatian biggest retail Company – Agrokor, faced some severe difficulties. The debts it had were so big that it had to confront the possibility of insolvency proceeding. However, since Agrokor is very important for Croatian economy and is the employer of many Croatian citizens, the Government, on April 6th 2017, enacted the new law on the procedure of forming an emergency government on companies that are of significant importance for Republic of Croatia, popularly known as Lex Agrokor. Lex Agrokor's task was to moderate the possible damages that insolvency proceeding on Agrokor could bring to the Republic of Croatia. Regardless the fact that the new law postponed insolvency proceeding on Agrokor, it is important to explain, if the "insolvency scenario" becomes reality, the consequences that insolvency proceeding on Agrokor can cause. If (and we all hope that this will not happen) Agrokor faces insolvency proceedings, this proceeding will have all characteristics of cross-border insolvency proceedings of group of companies.

[4] European Parliament, Directorate General for Internal Policies, 'Insolvency proceedings in case of groups of companies: Prospects of harmonization at EU level' (2011), Policy Department C: Citizens' Rights and Constitutional Affairs, Briefing Note, (PE 432,762) 1.

definition of this concept was developed[5] [6]. Thus, we found it important, before discussing the issue of the insolvency proceedings of group of companies, to provide some basic theoretical classification of corporate groups.

As a response to all the risks and challenges that were brought by expansion of business across borders, numerous variations of corporate groups were created. Their structures vary from simple to highly complex that can involve numbers of wholly or partially owned subsidiaries, operating subsidiaries, sub-subsidiaries, sub-holding companies etc.[7] According to Mevorach, there are different levels of integration between enterprises and autonomy levels of affiliates, as well as there are centrally controlled groups or groups decentralized in its organizational structure. "The legal structure of the firm may take various forms, based on equity linkages as well as contractual ones."[8] Also, companies members of a group can be intensely involved in the affairs of other member of a group, or each company may operate independently.

One of the classification differentiate vertically and horizontally integrated groups[9]. Vertically integrated groups are formed within a single industry, for example it can include suppliers, sellers and retailers in one specific industry. They are formed when one company gains strong control over suppliers, sellers and retailers, and that control is usually achieved by exercising purchasing power.[10] On the other hand, horizontally integrated groups are formed of many sibling group members that

[5] Ninth Council Directive relating to links between undertakings and in particular to groups, which proposed a definition of groups of companies and their mutual relation, never came into force because of lack of support of member states. More on the following link <https://www.mhc.ie/uploads/9th_proposal.pdf>

[6] Prior to the Regulation 2015/848 there were only two directives that contained definitions of group of companies. These are: Seventh Council Directive 83/349/EEC of based on the Article 54 (3) (g) of the Treaty on consolidated accounts [1983] OJ L193/1 and Directive 2004/25/EC of the European Parliament and of the Council on takeover bids [2004] OJ L142/12.

[7] UNCITRAL, *Legislative Guide on Insolvency Law – Part three: Treatment of enterprise groups in insolvency* (United Nations 2012) 6.

[8] Mevorach (n 1) 185.

[9] UNCITRAL (n 7) 7–8.

[10] ibid 7.

operates, either at the same level in a related field, or in a diverse range of unrelated fields.[11]

According to another classification there are centralized and decentralized groups in which the degree of financial and decision-making autonomy can be different, from the situation where each company has its own, separate decisions and responsibilities, to the situation where the decisions are centralized, and depend on parent company.[12]

When talking about definition of corporate groups in context of insolvency law we should emphasize that the first Insolvency Regulation 1346/2000 did not contain definition of groups of companies since it did not have provisions that dealt with insolvency of group of companies. So the definition of groups of companies was firstly implemented into Regulation 2015/848.

Regulation 2015/848 defines corporate groups as: "a parent undertaking and all its subsidiary undertakings"[13], while a parent undertaking means:

> "an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings"[14].

This definition is based on the traditional classification of group of companies, where the control, direct or indirect, plays the most important role. On one side, we have a parent company and on the other, subsidiaries or controlled companies, which indicate a pyramidal structure - a relationship that is based on hierarchy.[15]

The European Commission has in its Proposal[16] suggested more specific definition of groups of companies, where a parent company was defined as a company which:

[11] ibid 8.

[12] ibid.

[13] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings [2015] OJ L141/19, art 2, para 1, point 13.

[14] ibid art 2, para 1, point 14.

[15] Vuk Radović, 'Corporate Group Insolvency – Major Problems and Dilemmas' (2014) (1) Harmonius 271, 275.

[16] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) 1346/2000 on insolvency proceedings' COM(2012) 744 final.

i. has a majority of the shareholders' or members' voting rights in another company, or
ii. is a shareholder or member of the subsidiary company and has the right to:
    a. appoint or remove a majority of the members of the administrative, management or supervisory body of that subsidiary; or
    b. exercise a dominant influence over the subsidiary company pursuant to a contract entered into with that subsidiary to a provision in its articles of association.[17]

INSOL[18] also suggested a definition of parent company[19] which is almost identical to aforementioned definition from Commission's Proposal.
At the first sight it may seem that the Regulation 2015/848 did not accept the definition that was proposed by Commission or that was suggested by INSOL, but if we consider the fact that "control may be obtained by ownership of assets, or through rights or contracts"[20] it can be inferred that the definition from Regulation 2015/848 is basically the same as the one from Commission and INSOL.

As we can see, analyzed definition covers only integrated or centralized groups of companies. Thus the question arises, are mutually interconnected companies by coordination and not by control[21] also in the scope of the Regulation 2015/848? Furthermore, since above definition includes only vertically integrated groups of companies consisting of a parent company and at least one subsidiary company, it remains unclear whether horizontally coordinated groups also fall outside the scope of the

[17] ibid 21.

[18] INSOL Europe is the European organization of professionals who specialize in insolvency, business reconstruction and recovery. See more <https://www.insol-europe.org/>.

[19] INSOL Europe. *Revision of the European Insolvency Regulation, Draft Amended Version of Council Regulation (EC) No 1346/2000 on insolvency proceedings (as amended by Council Regulations of 12 April 2005, 7 April 2006, 20 November 2006, 13 June 2007, 24 July 2008, 25 February 2010 and 9 June 2011)* (INSOL Europe 2012) 30, 95.

[20] UNCITRAL (n 7) 15.

[21] Radović (n 15) 275, 276.

Regulation 2015/848.[22] Such omission in regulation can cause substantial problems in practice, particularly in light of fact that not all EU countries provide the definition of corporate groups in domestic company law legislation.

In order to prevent possible problems that may arise from a fact that there is no EU uniform definition of corporate group, it would be useful to allow all the Member States to define groups of companies according to their legislations and to put those definitions in annex of the Regulation 2015/848 in the same way as it was done with definition of insolvency proceedings. This way we would avoid that different tests are applied in the determination of what constitutes or does not constitute a corporate group.[23]

3. Specific Challenges in Case of Insolvency of Corporate Groups

The fact that insolvency law outgrew the "isolated circle of specialists"[24] only in late 1990s is surprising as well as the fact that insolvency "has caught relatively little attention among the academics and legislators, when put in relation to its practical importance"[25]. But the issue of insolvency of the group of companies has been even more neglected.

Due to lack of specific regulation, insolvency proceedings of group of companies have often been dealt individually as if it was the insolvency proceeding of just one isolated company, and not the company the member of the group.

Such approach is problematic in light of fact that "insolvency of a company, which is a member of a group of companies, will often initiate a domino effect, leading to the subsequent downfall of the other group members"[26]. However, emphasized problem is just one among many problems that arise in connection to insolvency proceedings of corporate groups. For example, as it was previously mentioned, there are many ways that group of companies can be structured – as vertical or horizontal,

[22] Stephen Madaus, 'Insolvency proceedings for corporate groups under the new Insolvency regulation' (2015) International Insolvency Law Review, 3.

[23] UNCITRAL (n 7) 14.

[24] Christoph G. Paulus, 'Group Insolvencies – Some Thoughts About New Approaches' (2007) 42 (3) Texas International Law Journal 819, 820.

[25] ibid 819.

[26] ibid 820.

as more or less centralized, as highly dependent of the parent company and based on control or based on coordination. In connection to that the question is whether to treat each group of company in the insolvency in the same way regardless its legal and economic structure, or should there be a difference in the treatment? Or to put it simple, whether more centralized and integrated group should be treated as one entity in the insolvency proceeding and decentralized or less integrated group separately?

Then, considering the previous paragraph, what about different situations when there is only one insolvent subsidiary, few subsidiaries or the whole group. Should in each case the insolvency proceeding be opened for all companies? The situation is clear if only one company is insolvent. But, what if all of them are insolvent or what if only a parent company and one of the subsidiaries become insolvent?

There is also a dilemma how to address the problem of liability of the subsidiaries. Should the whole group itself be liable for all the subsidiaries or just a parent company or should each company be liable independently? Debtors, especially the companies engaged in the group of companies often seize for opportunity to transfer assets or proceedings from one member state to another in order to obtain more favorable legal position, to the detriment of creditors. Since the insolvency proceeding must be effective in the first place in favor of creditors, thus "a link between affiliated companies in their insolvency proceedings"[27] should be established.

From theoretical standpoint, there are two possible approaches in treating insolvency proceedings of corporate groups: substantive consolidation approach and procedural consolidation approach.

3.1. Substantive Consolidation Approach[28]

Substantive consolidation approach is based on the idea that there should be one insolvency proceeding for all members of one corporate group. It is the court of the parent company's registered office who should

[27] Mevorach (n 1) 181.

[28] UNCITRAL defined substantive consolidation as "the treatment of the assets and liabilities of two or more enterprise group members as if they were part of a single insolvency estate." UNCITRAL (n 7) 2.

be competent to open and run insolvency proceedings for all members of the group, because all those companies were controlled by the parent company. In some situations that principle proved to be the most convenient and appropriate like in *Collins & Aikman* case.[29] However, in the majority of cases that principle did not work, so the broad interpretation was "narrowed" in the *Eurofood*[30] case where the Court of Justice of European Union stated that "in the system established by the Regulation for determining the competence of the courts of the Member States, each debtor constituting a distinct legal entity is subject to its own court jurisdiction"[31]. This way a new rule for insolvency proceedings of group of companies was set.

That opinion was later confirmed by INSOL, which stated that so called doctrine of substantive consolidation, where "all the companies of the group should be 'thrown' together into one estate"[32] should be the rare exception and in the vast majority of cases involving the insolvency of groups it is important that some kind of cooperation exist but without the group entities losing their separate identity.[33]

However, describing the substantive consolidation as a "rare exception", INSOL nevertheless left the room for accepting the substantive consolidation approach in some insolvency proceedings. So, in its Revision of European Insolvency regulation, INSOL proposed that in "the event that the assets, liabilities or agreements of one or more group of companies cannot be attributed to one company and consequently the insolvency proceeding with respect to these companies cannot be conducted in a meaningful way, each creditor of such company or companies, each liquidator of insolvency proceedings of such companies and the liquidator of the group main insolvency proceedings may request the consolidation of the insolvency proceedings."[34].

[29] The English court in this insolvency case, where there were 24 companies in ten different member states, promised to the local creditors the dividend that they would receive under a local proceeding, to divert them from opening secondary proceedings. The result was a considerable increase of the sales price. See more: Paulus (n 24) 826.

[30] Judgment of 2 May 2006, *Eurofood IFSC Ltd.*, C-341/04, EU:C:2006:281.

[31] ibid para 30.

[32] INSOL Europe (n 19) 91.

[33] ibid 92.

[34] ibid 98.

The similar was stated by Paulus, who found substantive consolidation approach as a more effective way to treat members of group of companies in insolvency proceedings.[35] According to him, one proceeding for all the companies of one group brings an advantage of "clarifying legal relationships" on debtor-creditor relationship. That way, when creditor has just one debtor, the creditor retain his trust in legal system.[36]

3.2. The Procedural Consolidation Approach[37]

The procedural consolidation approach is based on presumption that in the case of insolvency proceedings of corporate group, there should be separate insolvency proceedings for each and every company within the same corporate group. This means that insolvency test should be applied separately to each and every company within corporate group. However, recognizing the fact that all companies belong to the same corporate group, coordination of those proceedings is highly important. Thus special emphasize should be given to issues such as exchange of information among insolvency practitioners with the purpose to obtain a more comprehensive evaluation of the situation of the various debtors; organization of joint hearings and meetings; preparation of a single list of creditors and other parties in interest; establishment of joint deadlines; holding of joint creditor meetings or coordination among creditor committees.[38]

Procedural consolidation approach is generally considered as less controversial than the substantive consolidation approach since "the effect of procedural coordination is limited to administrative aspects of the proceedings and does not touch upon substantive issues"[39].

It seems that European Commission supports such opinion. In the Commission's Proposal it is clearly pointed out that even though each of the company in insolvency creates a group of companies, the regulation

[35] Paulus (n 24) 826.

[36] ibid 825.

[37] UNCITRAL defined procedural consolidation (or somewhere it is called coordination) as: „coordination of the administration of two or more insolvency proceedings in respect of enterprise group members. Each of those members, including its assets and liabilities, remains separate and distinct." UNCITRAL (n 7) 2.

[38] ibid 27.

[39] ibid.

must maintain an "entity-by-entity approach"[40]. It seems that substantive consolidation approach seemed to be too radical and hard to implement into European legislation because of the variety of insolvency solutions in member states. Thus the new Insolvency Regulation adopted a model of procedural consolidation with regard to regulation of insolvency proceedings of corporate groups.[41]

Procedural consolidation can be achieved in different ways. For example by appointing one insolvency practitioner[42] for all insolvency proceedings or by cooperation and coordination between the courts or between insolvency practitioners or insolvency practitioners and courts.[43] Some of these solutions are implemented in Regulation 2015/848. Firstly, there are provisions on communication and cooperation which are binding in their nature. Then, the provisions on coordination, even though non-binding, encourage joint activities through group coordinator, who is appointed to supervise all the insolvency proceedings open on companies that belong to the same group.

4. Insolvency Proceedings of Corporate Groups in the New Insolvency Regulation

Insolvency proceedings of corporate groups are regulated in Chapter V of the Regulation 2015/848. Section one deals with "cooperation and communication", and Section two with "group coordination proceedings", both of which will be examined in the following passages.

4.1. Rules on Cooperation and communication

Provisions on cooperation and communication are regulated in Arts. 56-60 of the Regulation 2015/848. Art. 56 addresses the issue of

[40] European Commission (n 16) 9.

[41] However, it has to be pointed out that not all of the legal experts think that the new Regulation adopted the procedural consolidation approach. According to Madaus Regulation 2015/848 sets a rule on corporate groups: coordinate, do not consolidate! He also stated that Regulation 2015/848 contains no provisions on "procedural concentration of insolvency proceedings of group members"[41], which means that there are no group COMI, insolvency practitioners etc. See more Madaus (n 22) 2-3.

[42] Regulation 2015/848 named it a "coordinator".

[43] See more on various and most common mechanisms for implementing procedural consolidation in insolvency proceedings, in Radović (n 15) 287.

cooperation and communication between insolvency practitioners, Art. 57 contains rules on cooperation and communication between courts, while Art. 58 addresses the issue of cooperation and communication between insolvency practitioners and courts. And finally, Art. 60 regulates powers of the insolvency practitioner in proceedings concerning member of a group companies.

The general purpose of rules on communication and coordination is to ensure continuous flow and exchange of information among all stakeholders involved in insolvency proceedings of corporate group[44]. Once when insolvency proceedings is opened regular business communication among group member stops. Insolvency practitioners take over the management role and it is for many reasons extremely important that insolvency practitioners mutually communicate and share information that are important for insolvency proceedings but, as well, for the future business activity of group members. With the purpose to achieve that goal Regulation states that insolvency practitioner "shall cooperate[45] with any insolvency practitioner appointed in proceedings concerning another member of the same group (...)."[46]

Furthermore Regulation imposes to courts to cooperate with any other court before which a request to open proceedings is pending or which has opened such proceeding[47]. And finally, the Regulation 2015/848 "requires and authorizes courts to provide relevant information and assistance to foreign insolvency practitioners if requested (...). In return, insolvency practitioners are obliged to communicate and cooperate with foreign courts if requested."[48]

[44] This conclusion comes out from Art 56 of the Regulation which prescribes that Insolvency practitioners shall cooperate when cooperation is appropriate to facilitate the effective administration of those proceedings, when cooperation is not incompatible with the rules applicable to such proceedings and does not entail any conflict of interest, while from the Art 57 of the Regulation can be concluded that the courts on the other hand shall cooperate if it is compatible with the rules applicable to them and does not entail any conflict of interest.

[45] The Regulation gives to the practitioner the right to choose the form of such cooperation. So, on one side the Regulation obliges the practitioner to cooperate, while on the other it does not bind him with the method to achieve it. Regulation 2015/848, recital 49.

[46] Regulation 2015/848, art 56.

[47] Regulation 2015/848, art 57.

[48] Madaus (n 22) 6.

Since cooperation and communication is broad concept encompassing wide range of activities Regulation gives guidance and interpretation of both terms.

In that sense, with regard to activities of insolvency practitioners, term communication covers activities such as: exchanging any information which may be relevant to the other proceedings; considering possibilities for coordination of administration and supervision of the affairs of the group members which are subject to insolvency proceedings; considering possibilities for restructuring group members which are subject to insolvency proceedings, etc.[49] Also, any insolvency practitioner appointed in insolvency proceedings opened in respect of a member of a group of companies may be heard in any of the proceedings opened in respect of any other member of the same group or/and request a stay of any measure related to the realization of the assets of the same group or apply for the opening of group coordination proceedings.[50]

Regarding cooperation and communication between courts, Regulation prescribes that those terms in particular refer to following: coordination in the appointment of insolvency practitioners; communication of information by any means considered appropriate by the court; coordination of the administration and supervision of the assets and affairs of the members of the group, etc.[51]

4.2. Rules on Coordination

Group coordination proceedings are examined in the Section 2 of Chapter V of the Regulation 2015/848. The Section 2 is divided into two Subsections. In the Subsection 1 (Arts. 61-70), which pertains to the group coordination procedure, we can find provisions on: who may request the opening of group coordination proceedings, the jurisdiction of the court which will open the proceeding, notice by the court to the appointed insolvency practitioners, court's decision on opening group coordination proceedings. The Subsection 2 (Arts. 71-77) includes the general provisions which concerns, among other things, the conditions for the appointment (and revocation of the appointment) of the coordinator and his/hers tasks and rights.

[49] Regulation 2015/848, art 56.
[50] Regulation 2015/848, art 60.
[51] Regulation 2015/848, art 57.

The purpose of coordination is to boost the efficiency of insolvency proceedings of groups of companies and to achieve the higher coherence between insolvency proceedings.

Unlike communication and cooperation, coordination is intended only for the insolvency practitioners, not for the courts. The Regulation prescribes that insolvency practitioner who is appointed in insolvency proceedings opened in relation to a member of the group may request opening of the group coordination proceeding. The court then, after the specific procedure (that will be explain later in the chapter), appoints the coordinator.

The court will open the group coordination proceeding if two following conditions are fulfilled: 1/ if the court finds that the opening of such proceedings is appropriate to facilitate the effective administration of the insolvency proceedings, 2/ if no creditor of any group member is likely to be financially disadvantaged and the proposed coordinator fulfills the requirements[52].[53]

According to the Regulation parties involved in group coordination proceeding are: insolvency practitioners who initiate coordination, courts who decides on coordination, and the coordinator who has central role in conducting the group coordination proceeding.

Because of the important role that the coordinator has in group coordination proceedings Regulation contains specific provision regarding appointment of the coordinator. The coordinator can be a person that fulfills the conditions for insolvency practitioner. Those conditions are the conditions of Member State in which he/she is obtaining the practice. But, the coordinator shall not be one of the insolvency practitioners already appointed to act in respect of any of the group members. Also, he/she shall have no conflict of interests in respect of the group members, creditors or other insolvency practitioners.[54] Madaus also added that "beyond these formal requirements, it should be considered that a coordinator must be a person who is internationally recognized for their expertise and experience by all insolvency practitioners in those proceedings to be coordinated" and that "currently, only a handful of

[52] The requirements for the coordinator are set in the Art 71 of the Regulation 2015/848 and will be explained later in this chapter.

[53] Regulation 2015/848, art 63.

[54] Regulation 2015/848, art 71.

candidates would appear suitable when the requirements are seen in this light".[55] Further, the Regulation gives the right to the court to revoke the appointment of the coordinator[56] if he acts to the detriment of the creditors or if he fails to comply with his/her obligations sets in Art. 72 of the Regulation[57].

Regarding the procedure for opening group coordination procedure, Regulation also gives thorough instructions. Firstly, insolvency practitioner files the request[58] to open the procedure before any court that has jurisdiction over the insolvency proceedings of a member of the group.

However, there is the "priority rule" that says that the court first seized to open the group coordination proceeding is the court that is in charge to open such proceeding and all the other courts have to decline jurisdiction in favor of that court.[59] But, there is also the "two thirds" exception, according to which in the situation where at least two-thirds of all insolvency practitioners have agreed[60] that another court is the most appropriate court for opening of group coordination proceedings, that court shall have exclusive jurisdiction, and all other courts shall decline jurisdiction in favor of that court.[61]

The request shall be accompanied by a proposal of the group coordinator, an outline of the proposed group coordination, a list of all other insolvency practitioners appointed to the insolvency proceedings of other members of the group and the courts involved and an outline of the estimated costs of the proposed group coordination.

[55] Madaus (n 22) 9.

[56] The court shall revoke the appointment of the coordinator of its own motion or at the request of the insolvency practitioner of a participating group member (see Regulation 2015/848, art 75).

[57] „The coordinator shall perform his or her duties impartially and with due care." (Regulation 2015/848, art 75, para 5.)

[58] The request shall be accompanied by a proposal of the group coordinator, an outline of the proposed group coordination, a list of all other insolvency practitioners appointed to the insolvency proceedings of other members of the group and the courts involved and an outline of the estimated costs of the proposed group coordination. (See Regulation 2015/848, art 61).

[59] Regulation 2015/848, art 62.

[60] The joint agreement must be in written form and must be submitted to the court that was first seized to open the group coordination proceeding. Also, the agreement must be submitted before the court makes a decision to open the group coordination proceeding (see Regulation 2015/848, arts 66, 68).

[61] Regulation 2015/848, art 66.

Following the request to open the group coordination proceeding, the court must give a notice[62],[63] to the appointed insolvency practitioners of the request for the opening the group coordination proceeding and of the proposed coordinator. After the notice (according the Art 63) was given and the period for the objections[64] (according the Art 64) has elapsed, the court may open group coordination proceeding. In its decision the court shall appoint a coordinator, decide on the outline of the coordination and decide on the estimation of costs and the share to be paid by the group members. The court shall notify the participating insolvency practitioners and the coordinator about his decision.[65]

Appointed coordinator has broad powers. He/she is in obligation to propose recommendations for the coordinated conduct of the insolvency proceedings and propose a group coordination plan[66], he/she can mediate any dispute arising between two or more practitioners. His/hers rights are for example to be heard and participate creditor's meetings, to

[62] The notice shall be sent by registered letter, attested by an acknowledgment of receipt. This is reasonable if we consider the fact that from the time the insolvency practitioner has received the notice, the period of 30 days starts to run, in which the insolvency practitioner may object to the inclusion in the group proceeding and to the proposed coordinator (see Regulation 2015/848, arts 63, 64).

[63] The Regulation 2015/848 states that the court shall give notice „as soon as possible" but does not specifies that time. Further in the articles Regulation 2015/848 defines the time in which the insolvency practitioners can object to the inclusion in the group coordination proceedings and to the appointed coordinator. In our opinion, the specific time in which the court is obliged to send the notice to the insolvency practitioners and the courts should be established (as it was done with the time in which an objection can be made) in order to speed up the proceeding (see Regulation 2015/848, arts 63, 64).

[64] The Regulation 2015/848 also gives the insolvency practitioners the right to object to the inclusion within group coordination proceedings of the insolvency proceedings in respect of which it has been appointed or to the person proposed as a coordinator. The consequences of objection are: exclusion of the insolvency proceeding from the group coordination proceedings; coordinators tasks will not be extended to members of group not participating in group coordination proceeding; refraining from appointing the insolvency practitioner against whom was objected. (See Regulation 2015/848, arts 65, 67).

[65] Regulation 2015/848, art 68.

[66] The group coordination plan should identify, describe and recommend measures that are appropriate to resolve the group insolvencies (e.g. re-establishing the economic performance of the group, settling intra-group disputes) (see Regulation 2015/848, art 70).

present and explain the group coordination plan, to request information from insolvency practitioners and so on.

However, the outcome of the group coordination proceeding actually does not depend only on group coordinator, because coordination operates only on voluntary basis. The Regulation 2015/848 thus in the Art 70 states that insolvency practitioners shall consider the recommendations of the coordinator and the content of the group coordination plan, but however they are not obliged to follow the coordinator's recommendations. They would only be obliged to give reasoned explanation why they rejected coordination.[67]

5. Insolvency of Corporate Groups in Insolvency Regulation of Republic of Croatia, Slovenia, Bosnia and Herzegovina

This chapter will review the regulation of insolvency of group of companies in Croatian, Bosnian and Slovenian jurisdiction. But before doing that, it would be useful to determine whether and how corporate groups are defined in selected jurisdictions. A closer analysis reveals that there is a definition for group of companies in all three jurisdictions. Since all those countries follow German legal tradition[68] in all three jurisdictions, group of companies are defined in almost identical way.

According to the Art 473 of the Croatian Companies Act[69] there are following main types of groups of companies: company with a majority of the shareholders' or members' voting rights in another company, parent company and subsidiary company, concern, companies with mutual shares, companies bounded by contracts. This definition is the same as those from Art 51 of Bosnian Company Act[70] and Art 527 of Slovenian Company Act[71].

[67] Madaus (n 22) 9–10.

[68] Dioniz Juric, 'Transparency of Groups of Companies' (2006) 27 (2) Collection of the Faculty of Law in Rijeka (1991) 939, 949.

[69] Croatian Companies Act from 1993, amended in 1999, 2000, 2003, 2007, 2008, 2009, 2011, 2012, 2013, 2015, can be reached in the Croatian Official Journal (*Narodne Novine*).

[70] Bosnian Companies Act can be reached in the Bosnian Official Jorunal (*Sluzbene novine Federacije BiH*).

[71] Slovenian Companies Act (Uradni list RS, No 42/2006) can be reached in the Slovenian Official Journal (*Uradni List RS*).

If we compare these definitions with the definitions from the Regulation 2015/848, Commission's Proposal and INSOL's recommendation, it can be concluded that the definitions from the three legislations are broader than the one from Regulation 2015/848. The three legislation in their definitions include also horizontally integrated companies, those which are bounded by contract and those which are decentralized in its structure.

Situation with regulation of insolvency proceedings of groups of companies in the three given jurisdictions is entirely different. Firstly, Croatian Insolvency Act[72], unlike Bosnian[73] and Slovenian[74], regulates insolvency proceedings of groups of companies. There is also a distinction concerning the application of EU law. While Slovenian and Croatian Insolvency Act refer to the provisions of the Regulation 1346/2000, Bosnian Insolvency Act doesn't contain such rule.

In light of aforementioned it can be concluded that among selected countries insolvency proceeding of corporate groups is regulated only in Croatian Insolvency Act. The Croatian regulation on that is rather modest. There is only one article, article 391 of the Croatian Insolvency Act that deals with the issue[75]. Closer examination of mentioned article reveals that this rule is of limited scope. It applies only if all members of corporate group have their seat in the Republic of Croatia. Notwithstanding to that, the value of addressed rule lays in the fact that it at least give some guidance how to treat insolvency proceedings of group of companies. In that regard, Croatian Insolvency Act accepted the principle of substantive consolidation. If the insolvency proceeding is opened on two or more companies that belong to the same group of companies, only one insolvency proceeding for all those companies will be opened.[76] However, analyzed rule will apply only to "domestic" insolvency proceedings and in that sense, they are not aimed at insolvency proceedings with cross border element. So, when it comes to the provisions on international

[72] Croatian Insolvency Act from 2015, can be reached in the Croatian Official Journal (*Narodne Novine*).

[73] Bosnian Insolvency Act can be reached in the Bosnian Official Journal (*Službene novine Federacije BiH*).

[74] Slovenian Insolvency Act 2007 (UL RS, No 126/07) can be reached on the Slovenian Official Journal (*Uradni List RS*).

[75] Croatian Insolvency Act 2015, art 391.

[76] Croatian Insolvency Act 2015, art 391(4).

insolvency proceedings, Croatian Insolvency Act refers to EU law, explicitly to the Regulation 1346/2000 (because Regulation 2015/848 was not in force in time when Croatian Insolvency Act was enacted).

As a consequence, in insolvency proceedings with the cross- border element EU Insolvency Regulation will apply.

In Slovenia, as it was mentioned before, Slovenian Insolvency Act does not contain special provisions on insolvency of group of companies[77]. As a result, in case of insolvency proceedings of group of companies each company within the group will be treated as separate legal entity and it will not be possible to have coordinated or one insolvency proceedings for all group members.

However, when it comes to the insolvency proceedings with cross border element, situation is different. Slovenia harmonized its Insolvency Act with European Union legislation, so with regard to those proceedings the situation is pretty much the same as in Croatia. Slovenian Insolvency Act refers to the provisions of the Regulation 1346/2000. It is stated in the Slovenian Insolvency Act that provisions of Regulation 1346/2000 will be applicable on all the insolvency proceedings covered by the Regulation.[78]

And lastly, regarding insolvency proceedings of group of companies in Bosnia, Bosnian Insolvency Act doesn't regulate insolvency proceedings of group of companies. However, Bosnian Insolvency Act regulates main and secondary proceedings. It also contain rules on mandatory communication and cooperation between insolvency practitioners of main

[77] "As it is a fundamental principle of Slovenian insolvency law that the insolvency of each legal entity is dealt with separately, there is no requirement for all members of a corporate group proceed under the same type of proceedings." [J. William Boone, *International Insolvency – Jurisdictional comparisons* (Sweet & Maxwell 2012) 366]. It is obvious that Slovenian insolvency law doesn't follow any type of consolidation approach, nor substantive or procedural. This raises the question of what would happen if the insolvency proceedings are open on the group of companies. If all the companies of the same group are located in the Republic of Slovenia, then the "separate legal entity" approach would be applied. Since there is no specific regulation for insolvency proceedings of corporate groups there are no specific rules on mandatory obligation on communication or coordination for insolvency practitioners. How harmful this is for creditors of bankrupt companies it remains to be seen in the particular insolvency case.

[78] Ante Vuković and Dejan Bodul, 'Bankruptcy Law in Transition – a Comparative Review. Croatian Challenges and Potential Solutions' (2012) 49 (3) Collection of the Faculty of Law in Split 633, 642.

and secondary proceedings. So, if an insolvency proceeding is opened for group of companies where some of the subsidiaries are located in Bosnia and some in other Member States of the European Union, separate insolvency proceedings will be opened, but Bosnian insolvency practitioner will have to communicate and cooperate with insolvency practitioners from other Member States.[79]

On the other hand, unlike Croatian and Slovenian law, Bosnian Insolvency Act does not refer to the provisions of the Regulation 1346/2000, which is expected since Bosnia is not a member of European Union.

6. Instead of conclusion: Toward more harmonized approach on insolvency proceedings of corporate groups

Insolvency Law is one of areas of law where harmonized and predictable legal insolvency law regime can play crucial role for successful and efficient resolution of insolvency proceedings. This is even more pronounced in case of insolvency proceedings of group of companies where there is a holding company with subsidiaries, network of companies and/or employees around the world. However, until recently, this problem was modestly addressed by legislators. Also, harmonization of insolvency proceedings of group of companies was out of the scope of the most respected international lawmakers such as UNCITRAL, INSOL and even EU Commission.

Research conducted in the paper also showed that even close and neighboring countries such as Croatia, Slovenia and Bosnia which were, not that long ago part of the same country, don't have unified approach regarding insolvency proceedings of group of companies.

This evident legislative gap, legislative diversity and unevenness of legal solutions can be a serious obstacle for efficient insolvency proceedings. It create space for forum shopping, frauds, transfer of corporate assets to more favorable jurisdiction, harm creditors etc. All those problems particularly came to surface in light of financial crisis that recently affected Agrokor, the biggest Croatian retail company with network of companies, not only in the region but throughout Europe. Agrokor crisis opened number of issues such as what would happen if insolvency proceedings is opened against holding (mother) company in

[79] Bosnian Insolvency Act, art 201.

Croatia? How it will affect other companies within the group? Is there going to be only one insolvency proceeding for the whole Agrokor group or for every company within the group? What is the legal position of creditors from other countries? Are they in better position if there is one insolvency proceeding for whole group or if there is separate insolvency proceedings for every group member, etc? There are also number of procedural issues which require straightforward answer[80].

Unfortunately, current national insolvency regulation of Croatia, Slovenia and Bosnia do not provide answer to any of those questions. This additionally raise tensions in already tense and complex situation.

Situation is somewhat better with the EU law, particularly since new Insolvency Regulation entered into force in June this year. As conducted research indicated, Insolvency Regulation, directly or indirectly, addresses majority of raised questions. It undoubtedly tackles in the heart of the problem of insolvency proceedings with cross- border element as well as of insolvency proceedings of group of companies. However, the effects of this newly enacted legal instruments are yet to be seen. Effectiveness of Insolvency Regulation depend on, at least, two things: 1/ national legislators who should as soon as possible harmonize national law with the Regulation and 2/ willingness of national courts, insolvency practitioners and creditors to give a chance to numerous legislative possibilities which new Insolvency Regulation offers.

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[80] Those are for example: deadlines for opening of insolvency proceeding, who can initiate opening of insolvency proceedings, who can appoint insolvency practitioner, if there were several insolvency practitioners what would be their mutual relationship, if any etc.

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Serbian State-owned Enterprises – Necessity of Corporatisation and the New Role of the State as Founder

Sonja Buncic*

Abstract: In accordance with the commitments undertaken in the accession process to the EU is necessary to change the basis of the policy of a state-owned enterprise that implies the establishment of good corporate governance. The new law on a state-owned enterprises in Serbia requires corporatisation and transformation of such enterprises into a joint stock company or a limited liability company, where the state is the only founder. When the state is a shareholder, its legal position is based on the shareholder's status and it is realized through the representatives in the company's assembly. The state, as a shareholder, needs to clearly distinguish its regulatory role, which it has as a public authority, from its shareholder's role, which imposes a kind of behavior that is in the interest of the business entity. That is the main precondition for creating a fair market competition and equality of all participants in the market.

Keywords: state-owned enterprises, public interest, membership functions, regulatory functions

1. Introductory remarks

Serbia has experienced a complete transformation from a Western Balkan country which did not accept the idea of joining the EU into a candidate country for EU membership. Today the Republic of Serbia is a candidate country, which is in the process of negotiations on EU membership. Eight chapters in the process of negotiations have been opened so far, but a very difficult part of the negotiations is the reform of state-owned enterprises and in this paper we deal with that issue. State-owned enterprises are an important part of Serbian economy and provide some of the basic infrastructure services to citizens and businesses. In accordance with the EU acquis, the basic policy of managing state-owned

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enterprises implies the establishment of good corporate governance of these business entities while respecting competition rules and fair competition.

The process of structural reforms, which imply organizational and financial restructuring, corporatization and complete or partial privatization of the sector of state-owned enterprises, as well as enterprises which have a different legal form, but perform the duty of general interest, precedes achieving the EU membership,. The Stabilization and Association Agreement between the Republic of Serbia and the EU requires operationally independent institutions (for the protection of competition and control of state power) to supervise the application of competition rules in the Republic of Serbia. This starting point has created a necessity to introduce changes in the organization of performing duties of general interest, as well as in managing state-owned enterprises in Serbia, and bringing in a regulation which would define a new framework for their work and business.

2. Overview of the regulation of state-owned enterprises in Serbia

State-owned enterprises represent a problem in Serbia on several levels: the first is that they are among the biggest losers[1], and the second is that they have been used in the interest of political parties[2] for years- for indirect financing of the parties, political discrimination in employment and distribution of leading positions at state-owned enterprises to party officials.

In around 730 state-owned companies in Serbia, which is the current number at the level of the republic,[3] province and local self-government, more than 100.000 people are employed. It is believed that public resources are misused through state-owned enterprises, due to a poor supervisory and control system. These beliefs have partially been confirmed by the findings of State Audit Institution.[4]

[1] Data from the Ministry of Finance 9622092 <http://www.naslovi.net/2014-04-16/rts/gubitak-u-javnim-preduzecima-51-milijardudinara>.

[2] Nevena Nikolić and others, *Towards greater transparency and clear criteria* (Fondacija Centar za demokratiju 2016) 29.

[3] Their number is constantly growing because it was 550 in 2005.

[4] Political Impact on Public enterprises and Media (*Transparentnost Srbija*, 2017) <www.transparentnost.org.rs> 9.

Bringing in a regulation which would define a new framework for the work and business of state-owned enterprises came as a result of the obligations taken in the negotiation process. Chronologically, the first law which harmonized the regulation in Serbia with the regulation in the EU was the Law on Public Enterprises (Official Gazette of RS No. 119/12, 116/2013 -authentic interpretation and 44/2014 -state law), which was brought in December 2012 (came into force on the 25th of December 2012). Soon after this law, the ruling party, oriented towards the European path of the country and with the majority in the Parliament, opted for bringing in a new Law on Public Enterprises, which was brought in February 2016 (Official Gazette of RS 15/2016). It was expected that this law would bring a range of essential novelties, which would practically initiate the long announced structural reforms of this important part of our industry. However, this law did not bring any essential improvements in the areas which are marked as key not only in public, but also in official documents[5], such as management professionalization, de-politicization, corporatization, management and control improvement, strengthening of the functions of strategic and long-term planning.

By introducing this law as the continuation of the previous one, harmonization with the regulation in the EU in this area was improved. However, the main issue remained unsolved, and that is its lack of application (especially in the domain of anti-corruption). For example, the government of Serbia decided not to announce a call for applications for all directors of republic state-owned enterprises, while the procedure of harmonizing founding acts, statutes and supervisory boards proceeded extremely slowly, with significant breaches of legal deadlines (in cases where such were prescribed).[6] The orientation of the government towards the corporatization of state-owned enterprises in Serbia is in accordance

[5] On structural reforms and Economic Reform Programmes see European Commission, 'Report of development of the Republic of Serbia in the process of European integration' SWD(2015) 211 final, ch 4; Council, 'Joint conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey' Press release 265/15.

[6] Even though conditions for director recruitment have been defined, clear criteria based on which the competent ministry suggests a candidate to the committee and based on which the committee reaches the final selection of candidates who have fulfilled all the required conditions have not been determined. Therefore, the choice, dismissal and system of evaluation of directors' work still represent risky processes from the standpoint of malversation and the emergence of corruption.

with the taken obligations in the process of joining the EU and the political strategy of improvement of their work, which is present in both Western Europe and developing countries.[7]

3. Introduction to SOE corporatization in Serbia

Public companies, as specific organizations for performance of activities of public interest are always established by the State. The decision of the Government of Serbia to change the legal form of every public company whose sole founder is the Republic of Serbia is the key step for finding solutions to the mentioned problems. The change of the legal form would make the 'transition' from a public company to a joint stock company an optimal organizational form. This way, legal status of today's public company would change significantly.

The first advantage which is ensured by changing the legal form is the obligation of the state as a shareholder to separate its assets from the assets of the future joint stock company. When starting a joint stock company, the Government of Serbia must present the capital of this newly organized company and divide it into shares.[8] Then, the state acquires the shares of that company as the counter value of the transferred capital and it becomes a member of that joint stock company. Membership is a set of rights and obligations that a member has in relation to the company. This results in the responsibility to act loyally and considerately towards other company members (shareholders) and company as well, in one legal community (joint stock company), and any disregard of that responsibility can lead to taking on liability for the damage.[9]

[7] Varouj A. Aivazian, Ying Ge, Jiaping Qiu, 'Can corporatization improve the performance of state-owned enterprises even without privatization' (2005) 11 (5) Journal of Corporative Finance 791, 802.

[8] That was a very difficult task, because nationalization of social property was conducted by force, as it was mentioned before, and these changes were not noted in the land registry.

[9] This clearly implies that the position of shareholders with respect to the company cannot be expressed in terms of ownership because a member of company is not its owner but the holder of its shares. This is why ownership and ownership structure have been misinterpreted in our country with membership in a joint-stock company and membership structure. See Jakša Barbić (eds) *Pravo društava, knjiga druga Društva kapitala, Svezak I., Dioničko društvo* (Organizator 2010) 341.

The second advantage is the possibility of separating shareholder's management and supervisory roles which the state has in the newly-organized company.

The third advantage, according to the Law on Public Companies, is that the continuity of business is in public interest. Based on the Decision of the Government of Serbia to change the legal form[10], the business of public interest, which has been performed by a public company, is to be passed over to a joint stock company which would be established as a result of change of legal form. Besides the business of public interest, the company may also be involved in other business on the market. The continuity of legal subjectivity does not change with different legal form of a business entity, only the organizational form is changed. In accordance with this legal provision, both aspects of business (business of public interest and market business) are conducted based on licenses. However, the company must submit a request for registration of the change of organizational form at regulatory authorities (for instance, the Energetic Agency of RS). Accordingly, there is no passing of title in the land registry or any other real estate register; only the change of organizational form of public company as the owner is registered.

4. Performing activities of general interest in business companies whose founder is the state

The state and business companies set different goals; the state guarantees achievement of public interest and while doing this it protects all the rights of its citizens. Business companies, on the other hand, conduct their business with the aim of gaining profit for their members. Although state and business companies have fundamentally different goals this does not prevent the state to achieve its goals by using the legal form of a business company. In comparative law practice, it is common for a state to operate as a business company, especially if its business is important for economy and everyday life of its citizens, or commonly known as the business of public interest.[11]

[10] Branislava Lepotić Kovačević, 'Public companies, business activities of public interest and concessions in the Republic of Serbia' (2004) (5-8) Law and Economy 500-501.

[11] Definition of business of public interest is given in Article 2 of the Law on Public Companies (Official Gazette RS No. 119/2012).

The issue of performing business activities of public interest as a business company (corporations) requires an in-depth analysis. *Firstly*, setting up a business company (even the one for performing the activities of public interest) implies organization of its business operations which are primarily aimed at making profit. *Secondly*, the significance of public interest activities requires that the main goal of the business company, which is to perform the activity aimed at making profit, should be overcome, as it is required to achieve other goals as well. The business goal of companies performing the activity of public interest must include the fulfilment of the activity delegated to them, i.e. protection of all users of this activity, on equal terms and in a transparent manner. *Thirdly*, when speaking of the organization and governance of business companies (corporations), where the state is the only member, there are two key issues. The first one refers to the complexity of determination and implementation of the business strategy of such business companies, and the second one refers to the organization and execution of shareholder's, management and control (supervisory) rights. The complexity is reflected in the fact that in such business companies the state should have a position and role which would make it equal to all other entrepreneurs and at the same it is obliged as a public authority to determine the goals of business in the interest of all citizens (especially in the course of performing the activities of public interest) and to put in order i.e. to regulate the market.

From the aspect of a public company which has the state as its founder, business may be difficult to conduct in cases when the founder mixes proprietary and regulatory roles, which is related to the issue of responsibility regarding the business obligations towards third parties. The Law on Public Companies clearly states the responsibilities of public companies which cover their liabilities by all their assets. It would be much easier if we knew the assets of a public company which uses them to cover its liabilities. There is the issue of responsibility with respect to the state which did not make clear distinctions between its own assets and the assets of public companies. Presently, due to the regulation changes, it is unclear who owns what and who is liable with which assets; the state as the founder is entirely responsible for all liabilities of its public companies.

5. Management and Supervisory roles of the State as a member of Joint stock company which is involved in business activities of public interest

The necessity of corporatization of public enterprises, which changed the legal form and became joint stock entities, means the necessity to familiarize with essential membership, management and supervisory functions which a member of a joint stock company has. In this way, a contribution to the efficacy of these enterprises by corporatization can be made.

5.1. Membership function of the state as the only founder

The specificities related to corporate governance where the state holds its shares are very important because of the influence which those business companies have on the economy.[12]When the state is a shareholder in a joint stock company (either minority or majority), its legal position (private-law) is based on the shareholder's status and it is realized through the representatives in the company's assembly. Every shareholder is entitled to manage the company by choosing persons who will have the management and supervisory role within the company. The shareholder's role in a joint stock company is performed by the Government of Serbia as the executive body of the state. Thus, based on the Decision of the Government, the Republic of Serbia can establish a business company or become its shareholder. A special decision of the Government is then the basis for the establishment of a business company. The level of influence on business activities of the newly established company depends on the number of shares the state holds in that company.[13]

If the state is the sole or majority shareholder, it makes decisions about the designation of board members independently in the company's assembly. Two authorities of these enterprises are stated by the law in

[12] At global level, about 20% of investments and 5% employment rate are achieved by legal entities which shareholder is the state, and in Central and East Europe these companies achieve 40% of production. See <http://rru.worldbank.org/Documents/Other/CorpGovSOEs.pdf> accessed 15 May 2017.

[13] Nina Širola and Siniša Petrović, 'State and Company' (2010) 60 (3-4) Zagreb Law Review 657, 665.

Serbia: *Supervisory board* and *director*. It should be noted that the state as a shareholder in a company means that the decision about the board members of a joint stock company which is involved in the business of public interest is made by the company's assembly and not at Government sitting. The Government appoints persons who represent it as a member, that is, a shareholder.

In order for the state to fulfil its role of a shareholder, it is necessary to specify the business goals of the company. This enables the state's representatives to have a clear idea about the tasks that the company needs to fulfil and to assess more easily whether the business activities of the company are in line with determined interests. This also facilitates work of people in the selected bodies. The state's role of a shareholder is highly complex in business companies which perform activities of public interest. On the one hand, the state as a shareholder is required to act in the interest of a joint stock company and to act so that this company gains profit while carrying out its business activities. On the other hand, the state needs to achieve another goal as well: to protect business activities which are of public interest. Furthermore, business companies performing activities of public interest, whose sole shareholder is the state, have the issue of adequate control of involvement in the business activities which are in the public interest.

The state, as a shareholder in a business company needs to make a clear distinction between the regulatory role which it has as a public authority, from its shareholder's role, which imposes a kind of behavior that is in the interest of the business company. Complete separation of state's responsibility for governing the business of public interest from the responsibility to act as a shareholder is the main precondition for a balanced market game and prevention of inequality of market participants. This can be achieved by prohibiting the persons who are directly involved in making regulations which control the market to be at the same time involved in the direct management of a business company which is responsible for the performance of business activities of public interest. Otherwise, a conflict of interest and reactions of public may be expected regarding the distortion of market competition and abuse of the monopolistic position.[14]

[14] "Mixing ownership and regulatory roles can cause conflicts of interest, as can the appointment of government bureaucrats, such as the energy or finance minister who sits

Besides the above mentioned issues, there is also the problem of influence of the state, as a member of a business company, on the autonomy of the company's Board of Directors in conducting business activities in accordance with the set goals and business interests. The company's Board of Directors must follow the predetermined goals, which is the case of every other business company where state is the shareholder, and it must lead business in line with regulations which are set by the Law on Business Companies with the aim of protecting business interests. It often happens that these business companies lose their autonomy and fail to fulfill their business tasks in accordance with the interests of the company because the state, as their shareholder, does not allow the Board of Directors to make strategic decisions independently or the supervisory bodies control the management, which results in the interference of public-law interests with those of the company.[15]

In order to avoid the mentioned problems relating to the governance of a business company whose shareholder is the state and which is involved in business activities of public interest, it is necessary to separate the shareholder's role from the management role, and especially from the supervisory role. The severity of this problem and real necessity of clear separation of these roles in a company are also indicated by numerous provisions of the Law on Business Companies. We have already pointed out that the Law does not allow interference and that it requires strict separation of functions of the Supervisory Board and direct business management, as well as the prohibition of a member of the Supervisory Board to conduct business activities or to be involved in the business of another company on occasions when it is not compatible with the role he has as a member of the Supervisory Board. The following question is particularly interesting: can state's representatives, who are members of the active political power, be involved in the activities of the Supervisory Board or be members of the Board of Directors as non-executive

on the board of the state-owned electrical utility. This minister may make decisions based on the political desires of his party rather than on the best interests of the SOE or what makes operational sense". Philip Armstrong, 'Corporate Governance and State-owned Enterprises' (2015) Spring Ethical Boardroom <https://www.ifc.org/wps/wcm/connect/1299668047f4ee8bae58ff299ede9589/EB_IFC_Phil_Armstrong.pdf?MOD=AJPERES >.

[15] Mirko Vasiljević, *Corporate Governance: Legal Aspects* (Faculty of Law, University of Belgrade 2007) 61.

directors? Is it possible to combine political function and membership in the Supervisory Board or Board of Directors, whose members are required to act in the interest of the company, without violating the market competition rules?("A company is identified as being connected with a politician if at least one of its large shareholders (anyone controlling at least 10% of voting shares) or one of its top officers (CEO, president, vice-president, chairman, or secretary) is a member of parliament, a minister, or is closely related to a top politician or party ")[16]In Europe, common practice is to select the members of relevant ministry, for those positions in the companies where the state is a shareholder, to have a technical professional role instead of a political one.

5.2. The state and performing the management role in SOE

The state, as the only shareholder in a company which performs business activities of public interest, should not hold a position which by any means differs from the position of public interest, should not hold a position which by any means differs from the position of other members of the organization. In joint stock companies, where state is the only shareholder, the state uses its representatives in the assembly to make decisions independently. Basic shareholder's right is the right to manage the company. This right is exercised through selection of the members of the company's Board of Directors. Should any abuse of performance of this shareholder's role (the right of management) occur, then the shareholder's right of the share in profit would be abused as well. Abuse of management rights, which the state has as the member of a joint stock company, occurs in cases when politically convenient and professionally incompetent persons are selected as the members of the Board of Directors. This affects the company's productivity directly and has adverse financial effects on the country's budget. Good and qualitative corporate governance is the only way to ensure good business and positive financial results.[17]

[16] Chiara D. Del Bo, Matteo Ferraris, Massimo Florio, 'Government in the market for corporate control: Evidence from M&A deals involving State-owned enterprises' (2017) 45 (1) Journal of Comparative Economics 89, 95.

[17] Graham Hollinshead and Mairi Maclean, 'Transition and Organizational Dissonance in Serbia' (2007) 60 (10) Human Relations 1551.

It should be emphasized that, besides the interference of regulatory and shareholder's roles, there is also a risk for the state as a shareholder, that is, member of the company, to infringe the regulations regarding the limited liability of the company. This means that the assets of a joint stock company are separated from the assets of the state, even though the state is a shareholder. By establishing a joint stock company where the state is a sole shareholder, the assets transferred to that company become the assets of a new legal entity. This raises the question of responsibility of a shareholder for breaching the regulations regarding limited liability.[18]

Minimization of this risk can be achieved with the establishment of an adequate organizational scheme that would provide efficient coordination of shareholder's, regulatory and supervisory roles because of the specific situation that the state is in, as well as due to its influence as a shareholder. Business activities should be conducted in accordance with the company's interests and in a way which would generate profit for both, company and its shareholders, but which would protect company's business activities as well. Based on the new law, the corporate governance is in line with European standards so it is obvious that the shareholders, that is, the members of the company cannot be executive directors. Separation of shareholder's, management and supervisory roles in the companies where the state is a shareholder is clearly emphasized. In the companies which have the state as the majority or a sole shareholder, the shareholder's and management roles are often confused. The reason for this are some defects in the system of state assets management, but also the failure to meet the selection criteria regarding the persons responsible for business management.[19]

Besides the competence requirement, which must be fulfilled by persons proposed for the executive roles in the company where state is a shareholder, it is necessary to introduce and follow the principle of assessment of behavior of the person having the management role. Persons with management roles are obliged to perform their duties

[18] Fiana Jesover and Grant Kirkpatrick, 'The Revised OECD Principles of Corporate Governance and their Relevance to Non-OECD Countries' (2005) 13 (2) Corporate Governance: An International Review 127.

[19] Jakša Barbić, 'System of joint stock company bodies' in *Corporate Governance* (Library Kaleidoscope 2012) 90.

conscientiously with great care of a good entrepreneur and in reasonable belief that his/her actions are in the best interest of the company.[20]

In 2016, the government of Serbia brought in a regulation on measures for the appointment of the directors of public enterprises, which predicts both oral and written tests for candidates which apply for the position of the director of a public company. A committee for controlling the recruitment process has been formed as well. This regulation prescribes measures according to which the results of candidates applying for the directorial position at public companies (whose founder is the Republic of Serbia, autonomous province or local self-government) are determined by assessing professional abilities, knowledge and skills. The mentioned regulation has been in force for only half a year, and the results cannot be clearly qualified at the moment. Anyway, this has been a significant step towards depolitization of public enterprises in Serbia, even though weaknesses have been noted as well. Interest in participation in these calls has not been so wide. Moreover, the choice of former acting directors whose party membership is clearly identified is still present.

The greatest obstacle for efficient business of the companies which perform activities of public interest and which have the state as a shareholder is the dependence of company's board members. This is due to a specific position of this company which board members, on the one hand, report to the company's assembly about their work and business, and on the other hand they report to the state. This means that they report to the ministries and even some individuals in the Government of Serbia or ruling political party. The conflict of authorities, that is, the situations in which the company is used for achievement of different short-term political goals to the detriment of the company is a significant obstacle to efficient business of the company.

Corporate governance of companies which are involved in business activities of public interest and which have the state as the only shareholder is very complex because of the impossibility to reconcile the interests of everyone involved, both internal and external groups.[21] Based on the principle of business, which should be in the best interest of the company, the Board of Directors must reconcile the business decisions with the necessity to protect business activity which is of public interest,

[20] Law on Business Companies, Republic of Serbia, art 63.
[21] Vasiljević (n 15) 55-64.

and it must, at the same time, conduct business in such manner to gain profit. From that aspect, it is of utmost importance to specify the business goals of the company in the statute and the article of incorporation.

6. Supervisory role in joint stock companies which have the state as their sole shareholder

Unlike the management role, which is the responsibility of the Board of Directors, the supervisory role needs more detailed explanation. The supervision, control of business activities, does not imply only the supervision from technical aspect but active involvement, as well, in the due care of entire company's business.

We should point out that our recommendation regarding the reorganization of future joint stock company is to introduce the two-tier system in the corporate governance. It means that supervisory role, performed by the Supervisory Board, would be strictly separated from the management role given to the Executive board. The Supervisory Board is entitled to establish the committees which can assist the board in its work and responsibilities which it has for certain sectors (audit committee, appointment committee, etc.)Two-tier system has strictly separated management and supervisory roles which cannot interfere with each other. Business supervision is a responsibility of the Supervisory Board which performs the controls of present situation, but it carries out the supervision as a preventive measure as well. This means that the Supervisory Board is responsible not only for the investigation of something that has already happened, but it should also act preventively and advise the board. This is direct shaping of the company's business policy. Furthermore, it selects and appoints the members of the Executive board. Supervisory Board controls the management with respect to business activities and compliance with company's regulations regarding the activities of public interest.

As regards the supervisory role*, required qualifications* of persons who are to be the members of the Supervisory Board *are* particularly important. Most corporate governance codes and national legislation leave it up to the company and their statute to define the qualifications a future member of the Supervisory Board or non-executive director should have. Special qualifications are required due to: the complexity of the business activity of public interest, size of the company, scope of business activities of the company and alike. The company itself determines which

special qualifications and characteristics of people are required, therefore the Law on Business Companies only stipulates who cannot be a member of Supervisory Board and leaves all other decisions to be made by the company. Negative determination is the result of the need to maintain an independent supervisor's role in the company and avoid potential conflict of interests.

Members of Supervisory Board in two-tier system are responsible for their actions based on the assumption of guilt. This means that, based on the general assumptions of guilt, the perpetrator can use his/her objections to prove that he/she was acting conscientiously, thus withdrawing the statement about his/her guilt established by the law. Members of the company's Supervisory Board are responsible based on the Law on Business Companies and provisions of the Criminal Law. The question is raised concerning the responsibilities of civil servants who perform supervisory roles in the company based on the selection of a company's shareholder (the state), which are, officially, beyond their job responsibilities. Will the state be held responsible for the damage they cause to the company because of the measures that have been taken or failed to be taken?[22]

Finally, the question concerning the supervision of the management in SOE, also affects the role of the Parliament in supervising the work of business companies of which the state is a shareholder. Parliamentary control and public insight are provided for the purpose of gaining political objectivity, precise political responsibility, transparency in political decision-making and involvement of citizens in making decisions regarding the performance of activities of public interest. Competent ministries are responsible to the Parliament, which means that they submit reports and make available for public and media all relevant information about business companies of which the state is a shareholder and which perform activities of public interest in compliance with the law. Success of parliamentary control depends on effective cooperation between the Parliament and Government and it is independent from the governance and control within the company.

[22] Širola and Pertović (n 13) 685.

7. Conclusion

The rules of corporate governance have to be applied in order for the shareholder's, management, and supervisory roles to be more effective and transparent in business companies which perform activities of public interest. Corporate governance represents the framework for carrying out work and supervision in the company. Although basic rules of governance in business companies can be imposed by adequate laws and other regulations, practice has shown that different codes often offer solution for effective management. Corporate governance is a part of a wider economic and legal context for business, and well established governance in business companies has influence on the development of economy and achievement of favorable conditions for new investments and further development.[23]

For public companies, that is, future joint stock companies of which the state is a shareholder, it is important to adhere to the rules which were adopted by the Organization for Economic Cooperation and Development under the name: *Guidelines for corporate governance at public companies.* The organization aimed at providing guidelines which would be helpful for Governments in the process of establishment of legal, institutional and regulatory framework which supports corporate governance. These guidelines emphasize the importance of reporting about public companies' business for the purpose of making their business available to public, Parliament and media. Accurate and timely information on all aspects of company's business leads to good corporate governance. In addition to that, corporate governance should protect the rights of shareholders, that is, the state in our case. The rights of shareholders that are to be protected are: adequate registration of state ownership rights, the right of share transfer, the right to know, the right to participate and vote in the assembly, the right of selection of the board members and profit sharing rights. Corporate governance in the newly established joint stock company which performs activities of public interest should facilitate its strategic governance by ensuring coordination between the assembly and board. In addition, it should enable supervision of the work of executive directors and increase level of responsibilities towards both company and shareholders, that is, assembly of the company.

[23] Branislava Lepotić Kovačević, 'Legal framework for corporate governance at public companies in the field of energetic' (2008) (5-8) Law and Economy 335.

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Short biography

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The Inherent Risks of Foreign Currency Credits and their Socio-economic Impact

Maximilian-Andrei Druță*

Abstract: Various lending operations of individuals and legal entities have contributed to social progress, to the well-being of individuals and to the investments made by enterprises. However, legal and economic transactions have two sides, a positive one, mentioned above, but also a negative one consisting of the inherent risks that a person accessing a credit assumes. These risks are more acute in case of foreign currency loans. This paper aims to analyze and synthesize situations where banks in EU member states offer credits in foreign currencies, pinpointing the implicit currency risks, focusing on loans in EUR/CHF granted in Romania during 2007-2008 and their socio-economic consequences, including the financing problems Romanian banks had to face as consumers initiated legal actions against them. At last, we will present the private law institutions at national level that may lead to conventional adjustments of contractual benefits and risks and the possible impact regarding the conventional adjustment and, in case of its failure, the constrained judicial adjustment and the contractual risks the banks have to bear.

Keywords: credit, banks, currency, risk, adaptation, balancing

1. Foreword

It is well-known that the most often used "tool" in the contemporaneity for obtaining cash by both individuals and legal entities is the bank credit contract. Criteria set by banks to categorize the various "applicants" to obtain such money resources may vary, however, depending on the currency in which the credit would be given to the customers.

The contract in question is *uno ictu* by nature, but with a successive/gradual modality of execution of the loan repayment benefit, which must be seen as a whole, thus suffering the influence of socio-economic factors that vary over time depending on context at a time.

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However, the remuneration obligation, i.e. interest payment and the obligation to administer the account with the interdependent obligation to pay the related commissions can be qualified as successive execution by nature[1].

In the present paper, I have exemplified bank credits in relation to the Swiss franc, presenting the social context in which Swiss francs were granted, the law applicable to bank credit agreements concluded between 2006-2008 and the solutions to which the courts, at the request of the consumers, appealed to maintain a balance between the parties' benefits and under what conditions.

Romanian legislators attempt to mitigate the negative impact of the overvaluation of the Swiss franc must be revealed, that is through Law no. 77/2016 regarding the payment of some real estate in order to settle the liabilities assumed by credits, hereinafter referred to as the "Giving in payment law", and through the law for completing the Governments Emergency Ordinance (G.E.O.) no. 50/2010 on consumer credit contacts, hereinafter referred to as the "Foreign currency credit conversion law".

Last but not least, it is worth mentioning the decisions of the Constitutional Court of Romania no. 623/25.10.2016 regarding the declaration of the partial unconstitutionality of the Giving in payment (*datio in solutum*) law and no. 62/07.02.2017 regarding the declaration of the unconstitutionality of the Foreign currency credit conversion law, which annulled the legal effects that the legislator attempted to produce in the field of credit agreements in general and credit agreements in CHF, in particular, remaining only the common law instrument of hardship to resolve unbalanced foreign currency credit contracts.

2. The credit notion and certain types of bank credits. The bank's obligation in relation to their clients

The existing Romanian Civil Code does not contain a definition of the credit agreement that includes the common elements of all banking lending operations, the bank contract is the only one regulated.

[1] Marieta Avram, 'Mai există dare în plată forțată după Decizia Curții Constituționale nr. 623/2016?' [2017] (1) RRDP 15, 22; Valeriu Stoica, 'O lectură constituțională, dincoace și dincolo de Legea dării în plată' [2017] (1) RRDP 185, 208; Radu Rizoiu, 'Paradoxul călătorului în timp a fost evitat... la timp: Condițiile (constituționale ale) dării în plată' [2017] (1) RRDP 138, 145.

The legal doctrine defines the bank credit agreement by establishing it as being essentially a contract with pecuniary interest, with *uno ictu* execution, for a fixed or indefinite period, whereby the bank, on the one hand, provides the contractual trust by providing funds to the client or to a third party, and on the other hand, the latter must reimburse the funds for a remuneration that the bank's client will always bear[2].

In relation to customer-type the credit contract can be either consumer (B2C) or business finance (B2B).

G.E.O. no. 50/2010 on credit agreements for consumers, which transposed into Romanian law Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Directive 87/102/EEC Of the Council, gives us a definition of the credit agreement in general in art. 7 point 2, and states that this is the "*contract by which a creditor grants, promises or stipulates the possibility to grant a consumer credit in the form of deferral of payment, loan or other similar financial facilities, except for service contracts Continuously for the supply of goods of the same kind, where the consumer pays for such services or goods in installments during their supply.*"

If the client of the bank is a consumer within the meaning given by Directive 13/1993 and of G.E.O. no. 50/2010 on credit agreements for consumers, as well as all other normative acts in the field of consumption, then the credit contract has to be qualified as a consumer contract. According to art. 7 point 1 of G.E.O. no. 50/2010 the consumer is a "*natural person acting for purposes outside his commercial or professional activity*".

Banks have multiple obligations both in the pre-contract phase and in the contract execution phase. In the pre-contractual phase, we recall in this regard the general obligation of good faith from which the obligation of contractual cooperation, the loyalty and the obligation of contractual information derive. In the execution phase, besides the specific obligations of the credit agreement, the banks are also obliged to negotiate the adaptation of the contract, derived from the theory of contractual solidarity and from the provisions of art. 1271 The Romanian Civil Code in which frustration *in genre* is regulated. Arts. 11 - 29 of G.E.O. no. 50/2010 also lists a number of specific consumer credit obligations.

[2] Lucian Bercea, *Drept bancar. Studii* (Universul Juridic 2014) 183, 184.

The main obligation is to inform consumers about the foreign currency risk in general and, in particular, the borrower in Swiss francs. The question we can ask is whether the banks only have an obligation to provide general information to consumers and any other clients, especially on the Swiss franc, or if the banks actually have an obligation to advise their customers.

It is obvious that the banks were under no obligation to educate their clients, and that such a behavior would be excessive and would slow down the commercial circuit, implying a lot of costs that would eventually be borne by the clients. The obligation to advise cannot be imposed on the bank, as long as that obligation exceeds general and special disclosure obligations, being a service which the bank could provide to its customers for a remuneration, thus excluding compulsory counseling of the clients, unless there is a contractual agreement to the contrary.

3. Credit in foreign currency in Romania. The main socio-economic impact of credits in CHF

We will refer to the granting of credit in a foreign currency, both in terms of the principle of good faith and the specific obligation to fully and accurately inform the consumer about the essential characteristics of the products offered. Banks had an obligation to inform consumers but also professionals about currency risk, presenting the reasons for the stability of the Swiss franc, it's course during the years preceding the granting of credit, and the degree of risk that a possible fluctuation of the course could bring, including significant deviations from the original projection, during the duration of the credit agreement. In this way, the consumer would have had the opportunity to make a rational choice in accordance with his interests.

The period between the years 2006-2008 saw Romania involved a vertiginous economic growth that started somewhere in 2005 and lasted until the end of 2008. During this period, the real estate market grew significantly, being characterized by what is known as a "real estate boom."

In this context, loans were loosely granted by banks, even without any guarantees, with only very large loans being followed by such diligence on

the part of the banks. As a rule, loans for real estate were mortgaged on the purchased price of the immovable property.[3]

In the banking market there were numerous offers made available to potential customers, both in foreign and national currency. In order to be eligible for one of the different credit types made available, there were various criteria set by banks to assess the creditworthiness of potential clients, and Swiss franc loans were those that could be accessed, in principle, even by those who were not qualified to obtain a credit in euros or in the national currency, the leu. At the same time, the interest on these types of loans was lower because the costs of the financing sources were lower than the ones in lei.

It is difficult to determine the main cause that urges the consumer to opt for foreign currency loans, to the detriment of those in national currency[4]. Recent studies indicate that key credit offers are made by banks to a certain category of potential clients. As a result, banks have a decisive influence on consumer credit options[5].

Consumers contractually agreed to return the monthly installments either in Swiss francs or in Romanian lei at the franc exchange rate on the day of maturity. The assumption of this obligation was in the light of the so-called stable exchange rate of the Swiss franc that did not suffer significant fluctuations, and presented itself as a reliable currency[6].

Lending was promoted in an attractive way, as banks were interested in signing as many of these contracts as possible, increasing their influence on the market and gaining more profit. The degree of information of the contractors was low, prompting them to enter in contractual relations with banks without having a clear idea of what they were actually doing, as the banks only performed their pre-contractual information obligation. Most of the time, this obligation was treated with superficiality by simply inserting a currency risk clause in the adhesion

[3] However, this was not unique in the region. See the Hungarian example on the same problem: Judit Glavanits, 'Legal tools supporting the household debt financing in Hungary' Studia Juridica et Politica Jaurinensis (2015) 2 (2) 1.

[4] Lucian Bercea, 'Protecția consumatorilor prin conversia creditelor în valută' (*Juridice*, 17 January 2017) <https://juridice.ro/essentials/705/protectia-consumatorilor-prin-conversia-creditelor-in-valuta> accessed 10 June 2017.

[5] ibid.

[6] Gheorghe Piperea, 'Argumente pentru conversia creditelor din franci elvețieni în lei' (*Piperea*, 9 March 2015) <http://www.piperea.ro/articol/argumente-pentru-conversia-creditelor-din-franci-elvetieni-in-lei> accessed 10 June 2017.

contracts, which theoretically, the clients would have had to get acquainted with by reading the draft contract. Some customers were disqualified from the leu or euro loans, but they were led/urged to conclude credit agreements in Swiss francs, thus posing the question of whether this trend, this impulse, was caused willingly by the banks or it happened objectively, naturally? The answer to this question is difficult to give and is not part of the scope of our analysis, which contains in its area of interest only the final result, namely the contractual imbalance suffered by the CHF currency against the leu, the socio-economic impact of this phenomenon, and the possibility of reshaping the legal situations thus created.

The Swiss franc rate ranged from about 2 lei between 2007 and reaching up to 4.25 lei this year, doubled or over. The conclusion is simple: borrowers will have to buy francs or repay the equivalent rate in lei at double the cost of what was originally envisaged. Also the euro and the US dollar had a vertiginous appreciation, as we will see later in this paper.

This phenomenon was caused by the decision of the Swiss National Bank to renounce the 1.2 CHF threshold for an EUR, on the ground of the monetary policy measures of the European Central Bank (ECB), leading to the CHF's appreciation towards the RON and leading to increased debt service for the borrowers in this currency.

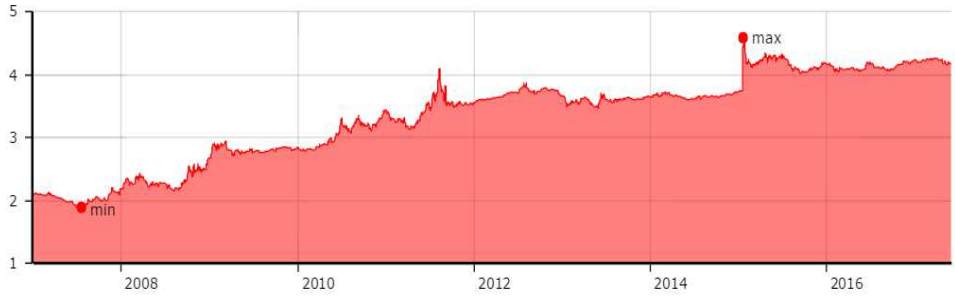
The exchange rate between the euro and the leu is the result of the correlation between demand and the supply of currency generated by commercial and financial flows. On the other hand, the exchange rate of the Swiss franc as opposed to the leu is obtained indirectly, depending on the euro - Swiss franc exchange rates, which depend on the demand and supply of currency between the euro area and Switzerland, without any influence from Romania on the quote of this course.

Clearly, debtors' ability to pay differs according to their characteristics. The distribution of CHF loans varied according to: (i) the destination of the credit, (ii) the volume of the loan, (iii) the income level of the borrowers, (iv) the indebtedness of the borrowers, and (v) the maturity of the loan[7].

[7] Banca Națională a României, 'Analiza creditelor în franci elvețieni 2015' <www.bnr.ro/files/d/Pubs_ro/Analize/R20150210Guv_analiza.pdf> accessed 10 June 2017.

In the following, we will present a series of graphs showing the evolution of the main foreign currencies in which credits were granted in Romania[8]:

CHF-RON



03 Jan 2007	31 May 2017	Variation (%)	Minimum	Maximum
2.0787	4.1977	+101.939%	1.8741	4.5817

EUR-RON[9]:

03 Jan 2007	31 May 2017	Variation (%)	Minimum	Maximum
3.3560	4.5702	+36.180%	3.1112	4.6481

[8] <http://www.curs-valutar-bnr.ro> accessed 11 June 2017; <http://www.expertulbanilor.ro> accessed 11 June 2017.

[9] <http://www.curs-valutar-bnr.ro> accessed 11 June 2017; <http://www.expertulbanilor.ro> accessed 11 June 2017.

USD-RON[10]:

03 Jan 2007	31 May 2017	Variation (%)	Minimum	Maximum
2.5374	4.0844	+60.968%	2.2319	4.3504

These data must be corroborated with the evolution of net average wage on the economy, which we present in the following:

The inflation rate by reference to consumption index has the following evolution over the period 2007-2016[11]:

[10] <http://www.curs-valutar-bnr.ro> accessed 11 June 2017; <http://www.expertulbanilor.ro> accessed 11 June 2017.

[11] <http://www.insse.ro> accessed 11 June 2017>.

Year	Index of the consum prices (%)	Inflation Rate (%)
2007	104,84	4,8
2008	107,85	7,9
2009	105,59	5,6
2010	106,09	6,1
2011	105,79	5,8
2012	103,33	3,3
2013	103,98	4,0
2014	101,07	1,1
2015	99,41	-0,6
2016	98,45	-1,5

*) The annual consumer price index measures the overall evolution of prices of purchased goods and service tariffs used by the population in the current year compared to the previous year (or another chosen year as the reference period). This index is determined as a ratio, expressed as a percentage, between the average price index for the current year and the average index of the previous year (or another chosen year as the reference period). Starting with 1992, the average price index for a given year is determined as the simple arithmetic mean of the monthly indices of that year, calculated against the same basis (October 1990 = 100). The annual inflation rate is calculated by subtracting 100 of the annual consumer price index.

Currency risk is inherent in any foreign currency credit agreement, so pre-contractual information is a formal one. Any client, whether an individual or a legal entity, can foresee a degree of risk when contracting a foreign currency loan, since earnings are obtained in national currency[12]. It is true that, although currency fluctuations can be anticipated, but their magnitude cannot. Nevertheless, the Court of Justice of the European Union stated in Case C-222/97 Trümmer and Mayer[13] that any national restrictions on this type of credit are a barrier to the free movement of capital, so that they must be accepted as such. This prompted both regular consumers and professionals to make loans in foreign currency without accurately perceiving or understanding the

[12] Lucian Bercea, 'Riscul valutar, impreviziunea și conversia creditelor în valută' [2017] (1) RRDP 24, 28, 29.

[13] Judgment 16 March 1999, *Trümmer and Mayer*, C-222/97, EU:C:1999:143.

currency risk involved and the fact that they will most likely not be protected neither naturally (e.g. by earnings obtained in that foreign currency or the way they would have been protected if the credit would have been granted in their national currency), nor by special contract terms[14].

The relative stability of a currency differs depending on economies, namely fixed rate or currencies exchange rate established on the free market, with possible influences from external factors such as the central bank. At the same time, the fluctuation parameters differ depending on the type of currency or the strong currencies (e.g. euro, US dollar, Swiss franc, etc.) and other currencies (e.g. Romanian leu, Hungarian forint, etc.)[15].

The word "risk" is not used here in a strict of contractual risk (e.g. fortuitous spoilage of a good) but in a broad sense, as a natural process that exposes the client (but also the bank) to a variation (monetary fluctuation) that can be in their advantage or vice versa. At the same time, this notion is not to be confused with the condition for the efficacity or the retroactive dissolution of a legal act, since the credit agreement is only affected by the term (an extinctive one, in terms of the right to use the amount of money borrowed, and more suspensive terms, given for the installment reimbursement). The exchange rate of the foreign currency in which the loan was granted is successive, varying from day to day, with various degrees of intensity. However, the contract is effective and is not automatically dissolved even in case of significant variations.

A foreign currency can thus be called only by reference to the national currency. Therefore, appreciation/depreciation is a relative phenomenon between at least two different currencies and, in our case, involves a reverse, directly proportional, process of the foreign currency against the national currency.

The risk is inherent, therefore implicit, because it occurs naturally and is the result of this relationship/relativity between the two opposing currencies. Of course, obtaining income in the currency of the contracted credit significantly reduces this risk, but it does not completely eliminate it. This happens if daily living takes place in a state that uses another currency, different from the one in which the credit was contracted (e.g. the amount of money paid in terms of installments of the granted credit

[14] ibid.
[15] ibid.

could have been converted into national currency at an advantageous exchange rate, since the foreign currency would have appreciated itself against the national currency).

Consequently, the currency risk assumption clauses inserted into credit agreements cannot be considered as proper assumption clauses, since in their absence we could not consider that the currency risk would have not been implicitly assumed. What needs to be determined is whether the fluctuation of a currency has been assumed at a very high level or it can reasonably be considered to have been assumed in this way. In these situations, we believe that the only legal consequence would be that the hardship theory could not be invoked under the common law, i.e. civil law (this - that the risk was not explicitly or implicitly assumed – being one of the negative conditions in Romanian law for its invocation). The solution would be to attempt to remove that clause on the grounds that it would be abusive, which would open up the option of initiating a common law process on the basis of hardship.

Even the principle of monetary nominalism, enshrined in art. 2164 RCC in force and art. 1578 of the old RCC, imposes the obligation to repay an amount borrowed in the same currency in which it was granted, even if there would be an increase in its value (in relation to another currency).

Swiss franc loans do not pose a systemic risk, with a small share in Gross Domestic Product (GDP) of 1.4% in the case of Romania (5 times and 7 times lower than in Poland and Hungary) and a low percentage of 4.7% from the total balance of bank credits, while in Poland and Hungary the levels are 3 times and 5 times higher. The share of these loans is about 10% of the total volume of loans granted to individuals, the number of those who contracted the loans in CHF being 2.1% of the total number of debtors in this category, namely 75,412 persons. By comparison, in Poland, the number of CHF debtors is over 500,000. The number of borrowers who have CHF loans decreased in the balance of Romanian banks in the last years by 31.8% as compared to December 2008, to about 35,200 persons[16].

In Romania, the percentage of foreign currency loans is still the majority and the foreign exchange risk materialized in 2015 for Swiss

[16] Banca Națională a României (n 7).

francs and US dollar borrowers as a result of the appreciation of these currencies against the euro without creating a systemic risk[17].

The granting of credits in national currency has started to have an upward trend towards a direction of sustainable lending to the economy. The weight of new loans denominated in euro to legal entities and individuals decreased to 24.5% in 2014 and to 20.5% in the first six months of 2015. In the private sector, euro funding has become insignificant, namely of 4.9 and 3.4% for new loans of the same periods. The consequence is that, at the level of the Romanian banking sector, the weight of credits in foreign currency to companies and consumers adjusted significantly, namely -8.4 percentage points between December 2013 and June 2015, standing at 52.8%[18].

The rate of non-performing loans related to foreign currency financing reached 19.4% in June 2015 (compared with 16.2% in the case of RON loans) and the gap between the two increased continuously since the beginning of 2015, the foreign currency loans representing 56.4% of the volume of non-performing loans in the balance of banks in Romania at that time[19].

Foreign currency loans remain the ones with the highest risk rate. The gap between their rate of non-performance and that of RON loans is significant, netting 5.1 percentage points in June 2015. The situation is similar for all types of credit, with the largest discrepancy being recorded for non-guaranteed consumer loans. Foreign currency loans represent the largest share of non-performing loans (74%, June 2015). Moreover, the indebtedness rate for borrowers who contracted foreign currency loans is higher than that of borrowers in domestic currency (48% vs. 31%). These developments reinforce the maintenance of a higher level of prudence, for both present and future, in terms of foreign currency lending, with the possibility of recalibrating of the current loan-to-value (LTV) and service-to-income debt (STID) in the scope of absorbing the currency risk movements that have occurred in recent years[20].

The prudential measures of the NBR involved *inter alia* the recommendation to reduce the interest rate differential for lei loans

[17] Banca Națională a României, 'Raport asupra stabilității financiare 2015' <www.bnr.ro/files/d/Pubs_ro/RSF/RSF2015.pdf> accessed 11 June 2017.

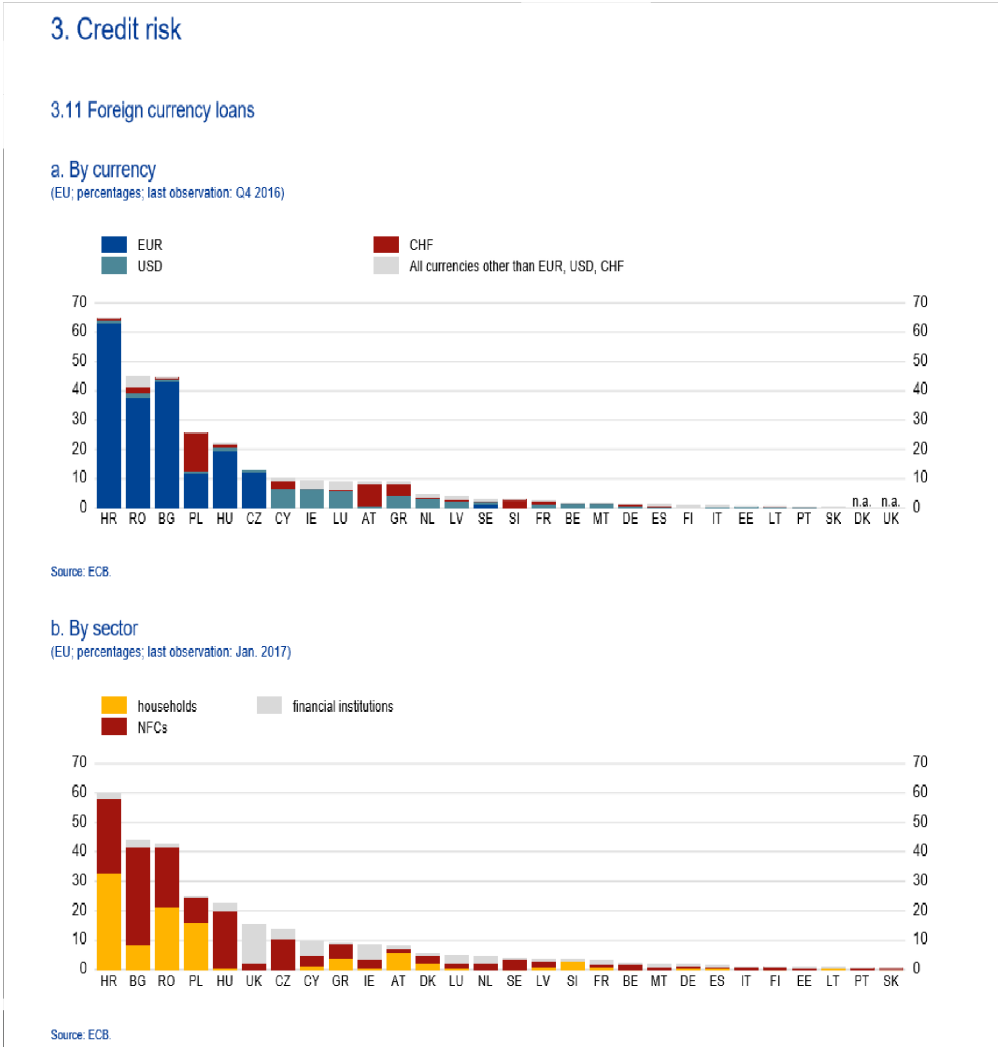
[18] ibid 20.

[19] ibid 39.

[20] ibid 61, 62.

versus foreign currency loans. It is obvious that in the case of the euro area, Member States are not subjected to any risk for credits in euros, but this issue still stands for credits in other currencies, even in highly developed countries.

In the European Union, foreign currency lending is as follows:



4. Some legislative solutions in Romania to soften the negative effects of the credits in the foreign currency, and their failure

Considering the Swiss franc's hyper-valuation in relation to the Romanian leu as the Swiss National Bank (SNB) lifted the franc-euro exchange rate ceiling, the borrowers had to buy Swiss francs at about a double rate so that a rate of 100 CHF would cost 420 RON (e.g. 1 CHF = 4.2 RON) instead of 210 RON (e.g. 1 CHF = 2.1 RON). However, the minimum wage in the economy has tripled so far and the inflation rate has increased for a while and has now reached a negative level, i.e. deflation.

Even the euro exchange rate and the US dollar, as we have seen, increased greatly, especially the latter, so that the above reasoning can be applied, within the limits of growth, also in the case of loans in these currencies.

In this context, the Romanian legislator tried to mitigate these negative effects by two recent laws, one in effect, namely Law no. 77/2016 regarding the payment of some real estate in order to settle the obligations contracted via credits, declared unconstitutional in large part by the RCC Decision no. 623/2016, while the other is in the state of draft law, namely the Law for completing the Government Emergency Ordinance no. 50/2010 on credit agreements for consumers, adopted by the Parliament of Romania, declared unconstitutional *in integrum* by the RCC Decision no. 62/2017.

This solution also took into account the fact that these loans were contracted for very long periods of up to 30 years, so that the legislative intervention seemed even more opportune.

The Giving in payment law was applicable to any contracted loan, as long as it was secured by a mortgage, while the Foreign currency credit conversion law should have been applicable only to Swiss francs.

For a very brief period, the Giving in payment law involved the possibility for the borrowed debtor to put an end to all the obligations resulting from the conclusion of the credit agreement, as well as the related agreements (e.g. mortgage, pledge, etc.) without necessarily requiring an imbalance between the benefits of the parties, it being sufficient for the debtor to be in self-declared financial difficulty.

In contrast, the foreign currency conversion law stated, in its form proposed for promulgation, that CHF loans were to be converted in RON

at the rate at the time of the signing of the credit agreement, applicable to contracts already unbalanced due to currency fluctuations.

As regards the Giving in payment law, the Constitutional Court of Romania (CCR), following multiple referrals, carried out an *a posteriori* control and found its partial unconstitutionality through Decision no. 623/2016, making it almost completely inapplicable.

Grosso modo, the CCR has stated that the provisions of the Giving in payment law are constitutional only insofar as they constitute an application of the theory of hardship, enshrined in the Romanian Civil Code in art. 1271[21]. This solution was criticized in the Romanian legal doctrine[22], not in terms of the unconstitutionality of the law in question, but in terms of the compatibility of the settlement of the obligations by the giving in payment of the guaranteed property with the application of the mechanism of hardship, respectively the adaptation of the contract or its termination *ex nunc* in the conditions set by the court.

As regards the Law on the conversion of foreign currency loans, the CCR made an *a priori* control and found its unconstitutionality in its integrity through Decision no. 62/2017.

Grosso modo, the CCR has stated that the reasoning and arguments contained in Decision no. 623/2016 remain applicable, hardship being the mechanism that courts need to consider for the adjustment of credit

[21] Article 1271 of the Romanian Civil Code, entitled *Hardship*, has the following content: *"(1) The parties are required to perform their obligations, even if their execution has become more burdensome either because of the increase in the cost of fulfilling their obligation or because of the decrease in the value of the consideration. (2) However, if the execution of the contract became excessively burdensome due to an exceptional change in the circumstances that would make it manifestly unfair to order the debtor to discharge the obligation, the court may order: a) adaptation of the contract in order to distribute fairly between the parties the losses and benefits resulting from the change of circumstances; b) the termination of the contract, at the time and under the conditions it establishes. (3) The provisions of paragraph (2) are applicable only if: a) the change of circumstances occurred after the conclusion of the contract; (b) the change of circumstances and the extent thereof have not been and could not reasonably have been taken into account by the debtor at the time of the conclusion of the contract; c) the debtor did not take the risk of changing the circumstances and could not reasonably be considered to have assumed that risk; (d) the debtor has attempted, within a reasonable time and in good faith, to negotiate the reasonable and equitable adjustment of the contract."*

[22] Bercea (n 12); Avram (n1); Stoica (n 1); Ionuț-Florin Popa, 'Impreviziunea și creditele oferite consumatorilor. Constituie darea în plată și conversia valutară remedii ale impreviziunii?' [2017] (1) RRDP 104; Rizoiu (n 1).

agreements in CHF, implicitly assuming that any other unbalanced currency credit agreements can rebalance benefits and losses by converting payment rates into the national currency, taking into account either the exchange rate from the date of conclusion of the contract, or the exchange rate from the date of the occurrence of the unforeseeable event, or the date of the conversion.

In short, all three solutions advanced by the CCR are wrong. The first solution, consisting in freezing the exchange rate to the one at the conclusion of the contract, is erroneous, since all the risks of unpredictability would be transferred to the lender, which would not be a fair distribution. The second solution, consisting in freezing the exchange rate to the one applicable at the time of the unforeseeable event, is also erroneous because virtually either the debtor (in the case of an overvaluation) or the creditor (in case of a significant depreciation) would be the one that would continue to suffer the imbalance since the applicable exchange rate would be the one at which the currency risk had already materialized, the only potential advantage being the assumption that the exchange rate of the currency would continue to appreciate/depreciate as appropriate, avoiding the worsening imbalances. The third solution, consisting in the freezing of the exchange rate at the one existing at the date of the conversion, is also wrong because the effects would only arise in the debtor's patrimony, rendering the application of the theory of hardship useless[23].

The most important take-away point resulting from the two decisions was that the CCR enshrined the applicability of the theory of hardship and under the old Romanian Civil Code, even in the absence of an express regulation, a solution that was anyway partially accepted by the courts and doctrine at that time[24].

Therefore, attempts to make a legal and general adjustment of foreign currency credit agreements failed to comply with the constitutionality test, with the CCR stating that, by virtue of a common law mechanism, i.e. hardship theory, the courts are entitled to proceed with judicial

[23] Bercea (n 12) 48.

[24] Avram (n1). See also Dec. nr. 21/1994, C.S.J., s. com., in Mădălina Afrăsinie, Monna-Lisa Belu-Magdo, Alexandru Bleoancă, *Noul Cod civil: Comentarii, doctrină și jurisprudență,* vol II (Hamangiu 2012) 589, *apud.* Dreptul nr. 12/1994. For an extensive study about hardship under the old Romanian Civil Code see C. E. Zamșa, *Teoria impreviziunii. Studiu de doctrină și jurisprudență* (Hamangiu 2006).

adjustments for balancing contracts in the event of a conventional adjustment failure.

It is obvious that the common law mechanism of hardship is within the reach of both individuals and legal entities, unlike the solutions that the two laws in question attempted to bring and out of which only individuals having the quality consumers would have benefited.

5. Directive no. 2014/17/EU Joint legal framework in the EU in the matter of implementation of foreign currency credits

The aforementioned Directive applies to contracts covering loans to mortgage-backed or otherwise immovable residential customers (Article 1). According to art. 23 paragraph (1) of the Directive "*Member States shall ensure that where a credit agreement relates to a loan in foreign currency, an appropriate regulatory framework shall be established at the time when the credit agreement is concluded in order to ensure That: (a) the consumer has the right to convert the credit agreement into an alternative currency under specified conditions; Or (b) other arrangements are in place to limit the risk of the foreign exchange rate to which the consumer is exposed under the credit agreement "and, in accordance with paragraph (2)*". The alternative currency referred to in paragraph 1 (a) shall be either: (a) the currency in which the consumer principally receives the income or holds the assets that finance the credit, as indicated at the time the most recent credit assessment (creditworthiness) has been made in relation to the credit agreement; or (b) the currency of the Member State in which the consumer either resided at the time the credit agreement was concluded or is presently resident.

Other provisions of the Directive include that if a consumer has the right to convert a credit agreement into an alternative currency, the exchange rate at which the conversion is to be made must be the market exchange rate applicable on the date of the conversion, unless the credit agreement specifies otherwise. At the same time, the consumer in foreign currency must be warned by the creditor periodically, on paper or on another long lasting support, at least in the cases where the total amount that remains to be repaid by the customer or the periodic rates vary by more than 20% in relation to the amount that would have arisen if the exchange rate applicable was the one at the time of the conclusion of the contract between the currency of the credit agreement and the currency of the Member State were applied. The warning is aimed at informing the

consumer about an increase in the total amount payable by the consumer, presenting, where appropriate, the right to convert into an alternative currency and the conditions under which it can be made, while explaining any other applicable rate limiting the risk of foreign currency exchange rate to which the consumer is exposed.

The provisions were almost faithfully taken over in Romanian legislation by O.U.G. no. 52/2016 on consumer credit agreements for real estate, as well as for amending and supplementing the Government Emergency Ordinance no. 50/2010 on credit agreements for consumers, the Romanian law transposing the Directive opting for the option where creditors ensure that at least one alternative currency version is available to the consumer, not necessarily both.

The Directive bases its idea on the assumption that the consumer of such loans must enjoy a degree of protection at least equivalent to that afforded to the consumer *stricto sensu*[25]. Although the real estate purchaser is supposed to be more diligent than an ordinary consumer, let's say, the European legislator has, of course, understood to offer the same degree of protection by the Directive, establishing in his favor the right to request (and obtain) the conversion (I) in the currency in which it derives its income or possesses the assets that finance the payment of the credit; or (ii) the currency of the Member State where the consumer was residing at the time of the conclusion of the contract or currently is resident in. The over-protection trend *inter alia* concerns the consumer's difficulty in comprehending the obligations he undertakes by contracting a (foreign currency) credit and the quasi-impossibility of avoiding unfavorable clauses creating a legal or economic imbalance, which puts him in a position of inferiority to the professional entity[26].

Ultimately, the possibility of obtaining the credit conversion into one of the above-mentioned variants has the role of facilitating the further execution of the assumed obligations, avoiding the negative impact of the occurrence of an external event creating a contractual imbalance, i.e. hardship.

[25] Bercea (n 4).
[26] ibid.

6. Conclusive considerations

Finally, we can see that the foreign currency lending trend has been increasing in Romania, but after the overvaluing of foreign currencies against the Romanian leu, this trend has decreased, also thanks to the prudential measures recommended by the National Bank of Romania and the fear of the population to resort to credits in a currency other than the one in which it earns its main incomes. Currency risk is inherent to foreign currency lending, and the weight of funding in currencies other than national currencies should be lower in relation to the latter for financial stability and a healthy economy, a conclusion valid for any EU Member State.

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The Challenges of Free Movement of Persons in the Western Balkan Context

Dr Éva Lukács Gellérné*

Abstract: Non-EU member Western Balkan countries aspire to join the EU which is a genuine condition hence they are surrounded by EU countries and they are dedicated to democratise within this framework. Free movement of persons is one of the most significant symbols of the EU which signals its integrity and unity. That is why opening the negotiation chapter on free movement marks a historic point in the accession process, too. The article sheds light on the general framework of negotiations and the general absorption capacity of Western Balkan states with a focus on labour market situation and push factors of migration. Also the state of affairs in the realm of legal and institutional approximation requirements is tackled upon, including issues of employment and social security. The article wishes to contribute to a better understanding of the underlying challenges in this field driven by the conviction that the historic window of opportunities is there for the region to advance on the European path marked by peace and progress.

Keywords: Western Balkan, free movement of persons, accession, employment, social security

1. Introduction

The EU has developed a policy aimed at supporting the gradual integration with the seven Western Balkan countries. On 1 July 2013, Croatia became Member State while Montenegro, Serbia, the former Yugoslav Republic of Macedonia and Albania are official candidates. Accession negotiations have started and different chapters of relevant EU law have been opened with Montenegro and Serbia, including of Chapter 2 on the free movement of persons in case of Montenegro. Bosnia and Herzegovina (it submitted membership application in 2016) and Kosovo[1] are potential candidate countries. All in all it has to be emphasised already

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[1] Kosovo has a Stabilisation and Association Agreement with the EU signed on 27 October 2015, in Strasbourg.

at the outset that, except Croatia that became Member State, negotiations are in early phase, and mostly rather general conclusions can be drawn regarding the implementation level of EU law in the Balkan aspirant countries. However, there are certain concrete things to signal which deserve attention. The general tendencies can be well depicted and some specificities are also worth mentioning.

2. The general process of implementing of EU law

As aspirant countries submit their application for EU membership they, at the same time, undertake the obligation to harmonise their laws with the *acquis communautaire*, including the rules on free movement for workers. After having received the application, the European Council mandates the European Commission to begin the accession negotiations. Afterwards, the formal negotiation process starts with mapping the differences between the legislation of the respective parties.[2] Chapter 2 deals with free movement for workers.

In case of Montenegro, the accession negotiations were launched in June 2012, however Chapter 2 has only been opened during the tenth meeting of the Accession Conference on 11 December 2017.[3] In case of Serbia's accession, negotiations were launched in 2014, however, Chapter 2 has not yet been officially opened, though, the screening report is available since 2015.[4] During these negotiations it is aimed at examining the situation in the aspirant country (i) and to receive guarantees and commitment from the aspirant country regarding the amendment of the diverging laws to comply with EU law (ii). This applies equally to all fields of EU law.

During the legal approximation process preparations are continuously screened and assessed by the European Commission in the yearly evaluation reports.[5] In each field separate screening reports are launched

[2] See on accessions in general <https://europa.rs/images/publikacije/07-35_Steps_Toward_EU.pdf> accessed 3 March 2018.

[3] <http://www.consilium.europa.eu/en/press/press-releases/2017/12/11/tenth-meeting-of-the-accession-conference-with-montenegro-at-ministerial-level/> accessed 3 March 2018.

[4] <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/serbia/screening-reports/screening_report_ch_2_serbia.pdf>

[5] Reports are accessible <https://ec.europa.eu/neighbourhood-enlargement/countries/package_en>.

(the Serbian screening report and the Montenegrin screening report on Chapter 2 – Freedom of movement for workers are officially available[6]).

Subsequently, the Commission presents its standpoint as regards compliance, possible adjustments or transitional arrangements. During these negotiations aspirant countries are given the opportunity to express their views on the transitional agreements, both in writing and in person.[7] Horizontally seen, not much is public of these talks. Also impact assessment can be prepared by the Commission if necessary to contribute to a Draft Common Position on a Chapter. Finally, the parties are required to reach a common position and approve the respective Chapter with common accord. The official closure of negotiations in every chapter is a prerequisite of launching the final stage of accession, namely to conclude the Act of Accession. Accession is an act of international law, the text of the Act of Accession has to be ratified by all Member States and by the aspirant country. These latter documents are already public.

It is to be stated already at this point that agreement on Chapter 2 is a serious precondition of accession. As Montenegrin Minister of European Affair, Mr. Aleksandar Andrija Pejovic said at the above-mentioned Accession Conference, free movement *„[…] represents the cornerstone of European integration. This chapter is of special importance to Montenegrin citizens, because on the day of EU accession they will have the right to stay, professionally develop and work in another Member State and have the same treatment as domestic workers in terms of working conditions and social and tax privileges."*[8] Johannes Hahn, European Commissioner (DG NEAR[9]) made it clear that the opening of the chapter was, however, also a result of *„[…] positive developments in the field of public administration and economic and fiscal reform"*.[10] Consequently, free movement is part of a wider approach, its success is

[6] MD 2203/13 – 15.11.2013.

[7] See in detail Éva Lukács Gellérné, 'Free Movement of Persons – a Synthesis' in Réka Somssich and Tamás Szabados (eds), *Central and Eastern European Countries After and Before the Accession*, vol I (Department of Private International Law and European Economic Law, Faculty of Law, ELTE University 2011).

[8] <http://www.gov.me/en/News/179448/Montenegro-opens-Chapters-2-and-3.html> accessed 3 March 2018.

[9] European Commissioner for Neighbourhood Policy and Enlargement Negotiations.

[10] <http://www.gov.me/en/News/179448/Montenegro-opens-Chapters-2-and-3.html> accessed 3 March 2018.

highly dependent upon the general economic and fiscal characteristics of the aspirant countries.

European Commission President Jean-Claude Juncker announced in September 2017[11] that his staff was planning a strategy for Serbia and Montenegro to join the EU perspectively by 2025, which strategy was adopted on 8 February 2018.[12] Based on this strategy accession can become soon a reality. Important is that a merit-based prospect of EU membership for the Western Balkans has been endorsed.

3. Free movement of Persons – Chapter 2

The *acquis* on free movement for workers enables EU citizens and their family members to work freely and on the basis of equal treatment in another Member State. EU migrant workers must be given the same advantages as to national workers when it comes to employment, working conditions, social and tax advantages, housing, collective rights.[13] The *acquis* also includes a mechanism to coordinate national social security provisions (social security coordination). Finally, migrant EU citizens have residence rights and right to have their diplomas recognised. EU rules aim at facilitating free movement by abolishing legal and institutional obstacles between Member States.

In the accession process not only the compliance with the above-mentioned areas and concrete, related provisions of the *acquis* is relevant, but also safeguarding mutual benefits and maintaining the ability of the aspirant country to cope with competitive pressure in general. Readiness to apply the rules depends not only upon the level of legal approximation but also on the general surroundings and implementing capacity in the aspirant state, be it economic, fiscal or political.

4. General requirements related to free movement for workers

11 <https://ec.europa.eu/commission/sites/beta-political/files/roadmap-soteu-factsheet_en.pdf>

12 European Commission, 'A credible enlargement perspective for and enhanced EU engagement with the Western Balkans' COM(2018) 65 final.

13 Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C202/47, art 45 and Regulation (EU) No 492/2011 of the European Parliament and of the Council on freedom of movement for workers within the Union [2011] OJ L141/1.

The main target objective of the screening and adjustment process is to judge the overall absorption and innovation capacity of the aspirant country. A balance of rights and obligations is targeted, taking into account several general factors. In the field of free movement of persons these factors are: general economic performance and labour market (i), level of push factors (like wage differences) and anticipated volume of migration (ii). These are the vital areas which are put under scrutiny, and the level of adherence largely affects whether progress can horizontally be noted.

4.1. General economic performance and situation on the labour market

A short and non-exhaustive benchmarking of data might sensitise the overall economic situation in the region. On the basis of the 2016 country reports[14] the following data is presented: GDP per capita as % of the EU28 average in purchase-parity-standard (PPS), employment activity rate, unemployment rate and gender situation within the labour market. Montenegro and Serbia are examined in detail.

In *Montenegro*, the gross domestic product per capita (% of EU28 in PPS) in 2015 amounted to 41%. The working population (15–64) *activity rate* is 12 percentage points lower than the average in the EU, but it has increased over the past five years from 57.3 % in 2011 to 62.6 % in 2015, and to 63.6 % in the first half of 2016. *Unemployment* is still relatively high everywhere. In Montenegro it declined modestly, from 19.7 % in 2011 down to 17.7 % in June 2016.[15] The unemployment and participation rates of women are lower in these countries. It is to be noted that these countries face a *gender imbalance* in their labour market. In Montenegro unemployment and participation rates of women (17.3 % and 56.6 %) remain lower than for men (18.0 % and 70.6 %).[16] The informal economy's size was estimated at 24.5 % of GDP.[17]

In *Serbia*, the gross domestic product per capita (% of EU28 in PPS) in 2015 amounted to 36 %. The employment rate reached 68.1% in 2015,

[14] SWD(2016) 360 final (2016 report on Montenegro); SWD(2016) 361 final (2016 report on Serbia); SWD(2016) 362 final (2016 report on the former Yugoslav Republic of Macedonia); SWD(2016) 363 final (2016 report on Kosovo); SWD(2016) 364 final (2016 report on Albania) and SWD(2016) 365 final (report on Bosnia-Herzegovina).

[15] SWD(2016) 360 final, 27.

[16] ibid.

[17] ibid 26.

while unemployment rate fell to 17.7 %. Labour market indicators improved further in 2016, to a large extent driven by rising informal, in particular agricultural, employment.[18] Problematic is however, that unemployment is still particularly high among young people — around 40 % of youth has no job. Women's position in the labour market is characterised by significantly lower activity and employment rates compared to men (56 % versus 72%). The informal economy was estimated at around 20–30 % of GDP.[19]

In *Macedonia* informal economy is estimated at 20–40 % of GDP.[20] The employment rate has increased to 52 % in 2015.[21] The gender gap remained existing, with women less likely to be in employment (42 %) than men (62 %). The unemployment rate remained persistently high, in particular for long-term unemployed and young workers, 24 %.

In *Bosnia-and-Herzegovina* the informal economy is estimated at 30–50 % of GDP.[22] Registered unemployment rate decreased from 43.6 % in 2014 to 42.9 % in 2015, but is still extremely high, one of the highest in Europe. Activity and employment rates remained at low level of 44.1 %.[23] Youth unemployment amounted to 62.3% in 2015. Additionally, there are large differences between female and male participation rates (32.1 % and 54.9 % in 2016).

In *Kosovo* the labour participation rate was extremely low in 2015: 37.6%.[24] Unemployment amounted to 32.9 %. The labour market outcomes for women were particularly weak, only 18.1 % of women were active. The share of unskilled workers among the total unemployed (57.1 %) and high youth unemployment (57.7 %) demonstrate necessity of strong state intervention in training and education. Informal economy is estimated high, albeit no concrete numbers are given in the reports.

Regarding the general economic situation, low labour market participation, high unemployment and gender imbalances pose challenges in the whole region, however, the scale is very divergent country by country. The informal economy is estimated between 20–30% in Montenegro and Serbia while to 20–40% in Macedonia and 30–50 %

[18] SWD(2016) 361 final, 29.
[19] ibid 28.
[20] SWD(2016) 362 final, 27.
[21] ibid.
[22] SWD(2016) 365 final, 34.
[23] ibid 36.
[24] SWD(2016) 363 final, 39.

in Bosnia-and-Herzegovina (similar could be Kosovo but no data is given in the report). It leads to losses of budget revenue, lack of labour protection, and contributes to large social contributions on legal jobs. The latter impedes job creation and fuels labour market duality, again, the scale is decisive here.

It is important to note that employment activity rate and unemployment rate are indicators that are always put under a test. With accession these are not taken as solved or the optimum reached, Member States are constantly working on bettering their indicators, fine-tuning their support mechanisms. During the preparatory phase of accession indicators can only increase or decrease to a certain level, hard work shall be anticipated afterwards as well.

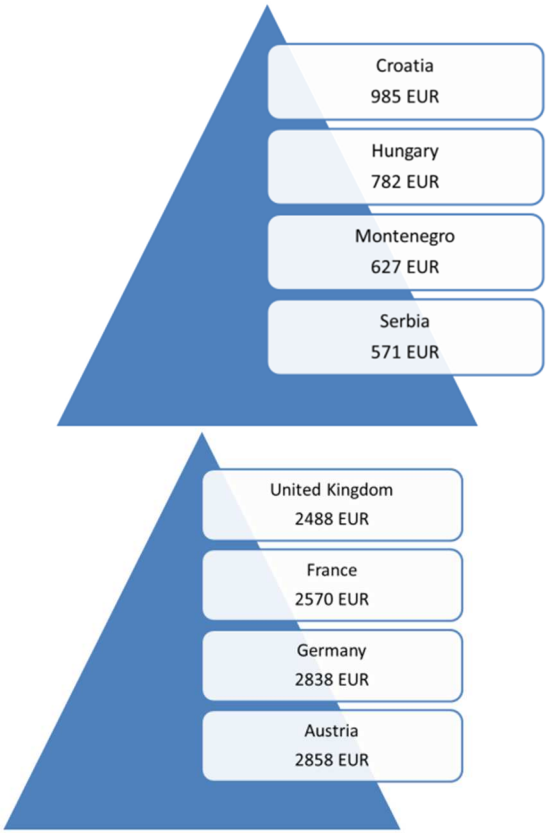
4.2. Level of push factors and anticipated level of migration

The 2016 report on Serbia explicitly stresses that *„[b]rain drain remains a major challenge*",[25] especially that *„[m]ore than 85 % of all unemployed have a medium or high level of education, pointing to considerable gaps between acquired skills and labour market demand*". In order to enhance matches between demand and supply, the reformation of the training system and the strengthening of competences of the national employment system are suggested.

Clearly, low employment rate and high unemployment rate, coupled with considerable shadow economy result in lack of labour protection which are per se push factors.

The strongest push factor, obviously, is created by wage differences. The following tables show the net monthly average wage in some European countries, focusing on traditional host countries like the United Kingdom and Germany.

[25] SWD(2016) 361 final, 30.



Source: <https://en.wikipedia.org/wiki/List_of_European_countries_by_average_wage>

The difference is striking and not only for Montenegro and Serbia, but for Hungary and Croatia as well. General bottlenecks are common in the region: lack of qualified and experienced workforce (specialist doctors, nurses, graduated civil engineers), lack of workers in accommodation and food service, lack of skilled workforce during touristic season and general shortage in the building industry (bricklayer, carpenter).[26] Brain drain is a challenge, which will not be solved by accession but will long persist even if accession becomes a reality.

[26] <www.ec.europa.eu/social/BlobServlet?docId=12650&langId=en> (for Croatia); <https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/networks/european_migration_network/reports/docs/emn-studies/13a_hungary_labour_shortages_study_en_may_2015.pdf> (for Hungary).

Anticipated level of migration is a term that tries to describe general tendencies of immigration and emigration. In Serbia, the report of the Commissariat for Refugees and Migration of the Republic of Serbia entitled "Migration Profile of the Republic of Serbia for 2014" paints Serbia as both migration and emigration country. According to the Profile data, Serbian diaspora numbers approximately 4 million people in the region and the world.[27] There are also predictions stating that by 2050 Serbia will be losing 30,000 people per year due to migration, caused by the turbulent social, political and war-related events that took place in the region during the last two decades.[28] The UN migration country profile is in line with this by stating that by 2050 the Serbian population will be 7 million (now 9 million).[29]

In Montenegro population will decline from 620.000 to 560.000.[30] Incoming migration is rather limited (20.000 work permits have been issued in 2015).[31] The trend is decrease like in all the neighbouring countries. In Hungary for example, the same prediction states a decline of approx. 1 million from 9.8 million now to 8.9 million by 2050,[32] Croatia from 4.2 to 3,6 million by 2050.[33]

5. Existence of EU-law conform legal and institutional framework

In addition to general trends also adherence to the concrete legal and institutional requirements is examined in detail in the accession process. These are non-discrimination in accessing the labour market and labour rights, functionality of the EURES system, social security coordination and the usage of the European Health Insurance Card.

In case of all the Western Balkan countries (Montenegro, Serbia, the former Yugoslav Republic of Macedonia and Albania as official

[27] See 'Migracioni profil Republike Srbije za 2012. godinu' <http://www.kirs.gov.rs/docs/migracije/Migracioni_profil_Republike_Srbije_za_2012.pdf> cited by Dragan R. Simic, 'Migration Studies in Serbian Universities' 7 <https://serbia.iom.int/sites/default/files/publications/documents/Migration%20studies%20in%20Serbian%20universities%20curricula.pdf>.

[28] ibid 6.

[29] <https://esa.un.org/miggmgprofiles/indicators/files/Serbia.pdf>

[30] <https://esa.un.org/miggmgprofiles/indicators/files/Montenegro.pdf>

[31] <http://wb-mignet.org/wp-content/uploads/2016/04/prez-golubovic.pdf>

[32] <https://esa.un.org/miggmgprofiles/indicators/files/Hungary.pdf>

[33] <https://esa.un.org/miggmgprofiles/indicators/files/Croatia.pdf>

candidates, Bosnia and Herzegovina and Kosovo as potential candidates) the European Commission prepares a yearly report on their capacity to cope with EU requirements. The series of 2016 reports point out progress in the level of preparations in all these countries (2017 reports are not yet available). Readiness reached a level sufficient to open Chapter 2 only in case of Montenegro. In a way, Montenegro is the current front-runner in negotiations. Also the European Parliament's resolution[34] welcomed *„[…] the continued progress in Montenegro's EU integration; […] the fact that Montenegro has achieved steady progress in the accession negotiations*".

5.1. Situation in Montenegro

In Montenegro the law on foreigners was amended in March 2016 with a view to entirely lift restrictions on access to the labour market of EU nationals. This has been the result of a gradual liberalisation, starting in 2013.[35] Montenegro has not waited until the date of accession and undertook liberalisation upfront. However, as statistics show, non-EU nationals are there in highest numbers at the Montenegrin labour market. The following table shows nationals with work permits in 2012/2013.

	2012	2013
Serbia	8846	3261
Bosnia and Herzegovina	4420	1869
Russian Federation	2993	1194
Macedonia	1485	537
Kosovo	639	307
Croatia	323	127

Source: <*https://www.eu.me/mn/2/02-prezentacije-s-bilateralnog-skrininga?download=514:employment-and-work-of-foreigners-in-montenegro*>

[34] <https://europeanwesternbalkans.com/2017/03/17/european-parliament-resolution-on-the-2016-commission-report-on-montenegro/> accessed 21 February 2018.

[35] 'Screening report of Montenegro' 2–3.

Regarding equal treatment in labour law, the Montenegrin Labour Code was in line with the prohibition of discrimination already in 2013. Similarly, the institutional changes induced by the EURES were in place, the Employment Agency of Montenegro was designated to fulfil the tasks.[36]

In the field of coordination of social security systems, Montenegro has a bilateral agreement on social security with 19 EU Member States while negotiations with Romania were ongoing at the time of preparing the 2016 yearly report.[37] The existence of bilateral agreements is very important, because both the personal and the material scope of these agreements correlates with EU rules. Consequently, when applying these bilateral agreements, the Montenegrin social security institutions in principle apply EU principles like aggregation or export of benefits. With regard to the area of health insurance, the law on health insurance adopted in December 2015 recognised the European Health Insurance Card in the country.[38] It has been a great step forward, because it means that EU citizens and their family members, if needing medically necessary treatment in Montenegro, enjoy the extraterritorial social protection granted them by EU social security coordination. The 2013 Screening Report already stated that Montenegro has reached a satisfactory level of alignment in the field of free movement for workers.[39]

Finally, Montenegro joined the NATO alliance as 29th member state on 5 June 2017.[40] The EU is more of an economic and political union without a harmonised security policy. That is why it is of outstanding importance that an aspirant country joins the defence alliance of NATO where EU countries also summon. Hungary, for example joined the NATO in 1999 and the EU in 2004 (together with Poland and the Czech Republic).

[36] ibid 4.
[37] Ibid.
[38] SWD(2016) 360 final, 32.
[39] SWD(2016) 360 final, 5.
[40] <https://www.nato.int/cps/su/natohq/topics_49736.htm> The instrument for its accession to the Washington Treaty (or the North Atlantic Treaty) was formally deposited with the US State Department.

5.2. Situation in Serbia

In case of Serbia, the screening report was adopted in September 2015.[41] At the time of the screening EU nationals and non-EU nationals were required to obtain a work permit to enter the Serbia labour market, and according to the 2016 country report liberalisation is still ahead.[42] New laws lifting the authorisation scheme for EU nationals and their family members are tabled to enter into force upon the date of accession. Foreigners on the Serbian labour market are overwhelmingly from Romania, other Western Balkan countries and Russia. Legally employed foreign workers have equal employment rights with domestic workers, Serbian labour law prohibits direct and indirect discrimination based on characteristics generally applicable in non-discrimination laws.[43]

The National Employment Service (NES) of Serbia is organised through a Central Office and 24 branch offices. It has 2.000 employees in total. In the 2015 screening report Serbia indicated that the NES did not expect difficulties in setting up and functioning of the EURES. Development of a national database/portal on job vacancies and job seekers started in January 2013.[44] However, according to the 2016 report[45] no new initiatives have been launched on EURES.

As regards coordination of social security systems, Serbia has bilateral social security agreements with 28 countries of which 19 are EU Member States. The bilateral agreement with Hungary entered into force in December 2014. The preparation of new agreements with the Russian Federation, Australia and Romania were well advanced. Electronic exchange of social security data has been operational with all countries in the region, except Bosnia and Herzegovina. These agreements are of utmost importance, too, to give the Serbian authorities the chance to apply provisions almost identical to EU law. The project of the European Health Insurance Card has not yet been launched. According to the report,

[41] <https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/pdf/serbia/screening-reports/screening_report_ch_2_serbia.pdf>

[42] 'Serbia, 2016 Report' 35, point 5.2.

[43] In respect of sex, origin, language, race, colour of skin, age, pregnancy, health status or disability, nationality, religion, marital status, family commitments, sexual orientation, political or other belief, social background, financial status, membership in political organisations, trade unions or any other personal quality.

[44] 'Serbia, Screening report 2015', 4.

[45] SWD(2016) 361 final, 35.

the capacity of social security institutions needs further strengthening to sufficiently address issues of adequacy, targeting and coverage.

Unlike other Western Balkan partners (e.g. Macedonia and Bosnia and Herzegovina), Serbia does not wish to join the NATO.[46] Only Albania (joined in 2009) and Montenegro (2017) are members of NATO.

In case of Macedonia and Albania, the 2016 reports note some progress in light of preparations being only at an early stage.[47] Macedonia should continue adapting the legal framework in line with EU *acquis* on access to the labour market, in particular as regards non-discrimination on grounds of nationality against EU workers. Albania should go on concluding social security agreements with EU Member States.

It is worth referring to language requirements in general. It is to be traced in the Montenegrin and the Serbian screening reports, and also former screening reports could be recalled here, that linguistic knowledge as conditions of employment is usually interpreted relatively broadly in EU aspirant countries. Regarding Serbia, ability to speak the language is a requirement for entering employment relation in pre-school facilities, primary and secondary schools, as well as when working in a healthcare facility.[48] In Montenegro there were also restrictions linked to educational institutions and health care activities. According to EU law the principles of proportionality and necessity govern language requirements, namely that the level of knowledge should be measurable to the post and be applied in a proportionate and non-discriminatory manner.[49] Language is a historic and cultural thing, countries need to safeguard their own mother tongue but they are, at the same time also required to provide for opportunities for other union nationals. This will be an important step forward on the European path already feeding the vision of European Union citizenship.

6. Some concluding thoughts

Except Croatia that became Member State, negotiations of free movement of workers are in early phase with the Western Balkan countries. Chapter 2 on free movement of persons has only been opened with Montenegro on 11 December 2017. Serbia's screening report was

[46] <https://www.nato.int/cps/ua/natohq/topics_50100.htm>
[47] SWD(2016) 362 final, 34 for Macedonia.
[48] 'Serbia, Screening report 2015' 3.
[49] Judgment of 28 November 1989, C-379/87, *Anita Groener*, EU:C:1989:599.

adopted in September 2015, but also the other aspirant countries made progress in their labour markets to approach EU standards and trends. Jean-Claude Juncker announced in his 2017 State of the Union speech that the European future of this region is a geostrategic investment in a stable, strong and united Europe based on common values. As a follow-up of the speech, the European Commission adopted a strategy on 6 February 2018.[50] According to the strategy, if conditions are fulfilled, based on a best case scenario, Montenegro and Serbia might perspectively join the EU in 2025, bringing the opportunity within tangible reach for them. Other Western Balkan countries still need to boost their efforts and follow the remaining milestones to advance on their European paths.

This is an absolute political necessity to integrate these countries into the EU. If we take a look at Europe's map, we see that Western Balkan is completely surrounded by EU states. Exactly this is the introductory sentence of the strategy: *„[…] the six Western Balkans partners are a part of Europe, geographically surrounded by EU Member States*." It is true that the EU has long been strongly engaged in the region, EU companies are the biggest investors in the Western Balkans and the EU has helped the countries to achieve overall political, economic reforms with improved democratic processes and to overcome the migration crisis. However, the accession perspective must remain credible and guarantee that it is a real merit-based process fully dependent on the objective progress achieved by each country. Of course, Western Balkan states must also remain determined to join and – as the strategy stresses – accession *„[…] is a generational choice, based on fundamental values, which each country must embrace more actively, from their foreign and regional policies right down to what children are taught at school*." These countries need to overcome the devastating legacy of war and conflict, help the handling of war crimes cases and build-up good cooperation with the neighbours in order to open a historic window of opportunity for young generations. And the EU should be capable of preventing that disputes that are resolved do not flare up again once the countries are inside the EU.[51]

[50] European Commission, 'A credible enlargement perspective for and enhanced EU engagement with the Western Balkans' COM(2018) 65 final.

[51] See for more <http://www.biepag.eu/2018/02/11/the-new-eu-strategy-for-the-western-balkans-whats-in-store-for-bilateral-disputes/>.

At the level of free movement of workers, two layers could be analysed, the state of affairs regarding general economic situation and the concrete *acquis* on free movement of persons. The general economic situation is characterised by challenges in labour market participation and gender imbalances and by a rather considerable informal economy. However, important is that trends are promising in terms of gradually increasing activity rates and decreasing unemployment rates. Activation measures on the labour market and alignment of demand with education could further improve the labour market situation. Additionally, regarding free movement, population movements will hit these countries to a large extent before and after the enlargement. The magnitude of population change differs but the decline is a common denominator in the region based on the predictions of the UN. It is equally valid also in the vicinity (like Hungary, Croatia). The decrease will be the result of not only emigration but natural decrease, too. Under these circumstances it is crucial to maintain balance of the population with enhanced measures, in particular in the field of education, employment and social protection with a special focus on family support schemes.

On the level of adherence to the *acquis*, negotiations – if any – are in early phase. Montenegro and Serbia have started the legal and institutional approximation process, they can report of a certain level of development. Until now Western Balkan countries had not spelled out any kind of derogations, they signalled their adherence to the basic principles of EU law. As far as we know about Montenegro and Serbia, these countries have introduced or undertook to take liberal measures regarding access to their labour markets, consequently, no derogations are awaited on their sides. The EURES network will be in place upon accession and the practice gained from application of bilateral social security agreements with EU countries will genuinely contribute to the development of administrative capacities. Montenegro already applies the European Health Insurance Card which has been a great step forward.

Last but not least, strengthening the administrative capacity for ensuring the application of the *acquis* and raising awareness about EU rules in general remains a substantial challenge for all the respective countries.[52]

[52] Administrative capacity is an important issue for also Montenegro <http://poslodavci.org/en/news/mef-in-public-debate-montenegro-and-eu-free-movement-of-workers/> accessed 10 March 2018.

Finally, I would like to finish my contribution with a quote from Estonian Minister of European Affairs, Sven Mikser – said at the 10th Accession Conference with Montenegro – which I wholeheartedly endorse: *„[…] the policy of enlargement […] has the true power to bring about changes in the lives of citizens and to continue to represent a strategic investment in the peace and progress of the whole of Europe".*[53]

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Short biography

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[53] <http://www.gov.me/en/News/179448/Montenegro-opens-Chapters-2-and-3.html Download 3 March 2018>

[54] See for CV and publications <https://www.ajk.elte.hu/en/content/gellerne-dr-lukacs-eva.t.1144>.

Compatibility of Legislation in Bosnia and Herzegovina with EU Law in the Field of Intellectual Property Rights as a Subject of Foreign Direct Investment

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Abstract: Investing technology, which is protected under patents and other intellectual property rights of foreign investors in Bosnia and Herzegovina (BiH), is one of the forms of foreign direct investment. If foreign investors decide to invest their technology which is protected by intellectual property rights, they must be sure that the legislation of the state they invest is in stable and in line with international conventions and in particular with the EU, due to commitment of BiH in accordance with Agreement on Stabilization and Association 2008. In 1992 BiH ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States from 1965. The BiH Constitution guarantees protection of the right to property and private capital. The Law on Foreign Direct Investment Policy in BiH was adopted in 1998 and regulates this area and the Law on Foreign Trade Policy of BiH and other laws and bylaws. In the field of intellectual property rights, in 1992 BiH ratified Paris Convention for the Protection of Industrial Property and most other international conventions.
The paper offers an analysis of BiH legislation governing intellectual property rights and foreign direct investment in order to determine whether the legislation of BiH satisfactory and whether it is sufficiently compatible with the EU law and therefore attractive to foreign investors.

Keywords: intellectual property rights, foreign direct investment, technology, legislation, BiH, EU law

1. Introduction

In order to improve its position in the world Bosnia and Herzegovina had to harmonize its national legislation with international agreements. BiH also had to harmonize its legislation with European Union law and the World Trade Organization, whose membership BiH is trying to join.

BiH has acceded to international conventions which govern the protection of foreign investments and also adopted its national legislation in this field. In the field of intellectual property rights BiH has acceded to

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international multilateral and bilateral conventions and adopted their domestic legislation in this field with the by-laws that accompany its implementation.

Foreign investment affects its relevant the scope, structure and direction of international trade, in addition to the status of companies that have invested in investment funds. Especially important are those investments that are related to the transfer of modern technology and patents that are protected. According to statistical data the majority of foreign investments are in countries in transition because they have the most attractive markets and thereafter decreasing.

Countries which are receive investments try that to provide three objectives with regulations regardless of the investment form: to improve local productivity and technological development, to activate and encourage the participation of the local economy and supporting activities and to minimize foreign competition in commercial areas run by local businesses. This policy it was legally regulated only the most essential issues such as the policy of minimum legislation, the policy of encouraging foreign investment with the participation quota of local politicians and local control.[1]

2. Definition and Types of Foreign Investment

In the view of the prevailing theory, foreign investments are transfer of the material from one state, i.e. capital exporting country, in another country i.e. the host country in exchange for direct or indirect participation in the company's income.[2] This includes the transfer of movable and immovable property and intellectual property rights. Foreign investment can be divided into direct investments, portfolio investments or investments in securities and mixed investments or other contractual forms of cooperation.

Direct foreign investment means foreign investments that can be qualified as a long-term relationship between the investor and the country

[1] See Radovan Vukadinović, 'Medjunarodno pravna zaštita stranih investicija' (2002) 39 Pravo i privreda 453, 455.

[2] *Encyclopedia of Public International Law* (1985) vol 8, 246; also Radovan Vukadinović, *Medjunarodno poslovno pravo, opšti i posebni deo* (2nd edn, Udruzenje za evropsko pravo 2012) 235; also Aleksandar Ćirić and Radomir Djurović, *Medjunarodno trgovinsko pravo*, posebni dio (Faculty of Law, University of Nis 2005) 319.

in which to invest their capital, through some form of business organization that conducts business in that country for the purpose of generating a profit and with the immediate impact of investors on business of that company, as well as bear the business risk.[3] Direct investments exist when a national of a state, i.e. exporting country invests in an entity national in another country i.e. receiving state with the intention to ensure a lasting interest in that company. From the above definition it follows that the essential elements of direct investment: a) the existence of permanent interest, and b) a certain degree of control over the company.

Lasting interest implies the existence of a long-term relationship between the direct investor and the company. This means that the investor is actively involved in the company in order to make profits.

A certain degree of control over the company involves a significant degree of influence over the management.[4] Control is usually manifested by participating in the management of the company. Which level of control is required is factual question and depends on the structure of ownership in the company. In comparative law it usually amounts to 10%.

According to OECD "Direct investment is a category of cross-border investment made by a national in one economy (the *direct investor*) with the objective of establishing a lasting interest in an enterprise (the *direct investment enterprise*) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The "lasting interest" is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise."[5]

There are three types of foreign direct investment, as follows: a) new investment (greenfield), b) investments by acquiring and acquisitions (mergers and acquisitions) and c) joint venture. New or greenfield investments are investments that established a new company,

[3] Ćirić and Djurović (n 2) 320; Predrag Cvetković, 'O efektima stranih invvesticija: izmedju stvarnosti i predrasuda' in D. Todorović (ed), *Kvalitet medjunarodnih odnosa, svest o regionalnom identitetu i mogućnost saradnje i integracija na Balkanu* (2004) 159; Aida Mulalić, 'Instrumenti za zaštitu i podsticanje direktnih stranih investicija u BiH' (2010) 3 Anali Pravnog fakulteta Univerziteta u Zenici 211, 213.

[4] Vukadinović, *Medjunarodno poslovno pravo, opšti i posebni deo* (n 2) 236.

[5] *OECD Benchmark Definition of Foreign Direct Investment* (4th edn, 2008) 17.

subsidiaries, branches, representative offices or business units. These investments created a new business entity as a legal entity or without the properties of the legal entity if it is established in the form of branches, representative offices or business units.

Direct foreign investments occurring through mergers and acquisitions are created when foreign natural or legal person is buying shares or shares in companies of the host country and the companies combined with their existing companies in the exporting country or acquire the right of majority control in companies whose the stocks or shares in purchased.

Joint ventures occur as various types of contracts in which the foreign investor and the domestic person establish a common society as a kind of partnership. With this type of transaction you can establish business venture for a single project or a permanent business relationship. The Contracting Parties shall jointly manage a business venture and also together bear the risk of the transaction and profit-sharing.

Portfolio investments are the types of foreign investments, which means that a foreign individual or legal entity invests its funds in the purchase of securities with the intention to realize profits without management companies. The primary objective of the investor is profit in the form of dividends without affecting the management of the business organization. Investor buys the securities with the right of participation and debt securities. Can be a bond, financial derivatives, or other securities. The most commonly are investments in financial institutions such as insurance companies, pension funds and the like. Portfolio investments investors are not protected by international agreements, but protection of these investments is provided under national regulations. Investors bear higher risk than direct investment because the profit from the investment portfolio of investments depends on the situation on the capital market. These types of investments are not suitable investments for technology that is protected by intellectual property rights because they are characterized by the need for quick resettlement and search the most profitable capital markets.

Under the mixed investments or other forms of cooperation considered the contractual non-institutional joint ventures, franchises associated with BOT or BOOT arrangements, different investment contracts or transfer of intellectual property rights, often in the form of licensing agreements, agreements on the conduct of the company and so

on.[6] Often they can be found under the name of the new forms of investment. Their subject is the transfer of technology and provision of services in the host country through contractual instruments. These forms of international investment are among the forms between international trade and foreign direct investment. If they are concluded in the form of licensing agreements, service contracts and turnkey contracts it is a technical know-how and in contracts due to corporate governance it is entrepreneurial know-how.[7]

Mixed investments are eligible for investment technology that is protected by intellectual property rights in the economy of other countries. Mostly it is not aim for itself but it is monitors financial investment in the context of foreign direct investment in new investments or joint ventures.[8]

3. Protection of Foreign Investment in BiH and Technology that is Protected by any of Intellectual Property Rights

3.1. Direct foreign investments in BiH

The level of attractiveness of the country for foreign investment depends on the relationship between the costs that investors have before investment and benefits that are expected after the completion of the investment.[9] The pre-entry costs may result from search and information gathering on local market conditions as well as on industry and firm performance. Investment costs also include risks and adjustment costs related to local institutional environment, rules and regulations, etc.[10]

[6] Vukadinović, *Medjunarodno poslovno pravo, opšti i posebni deo* (n 2) 239.

[7] Ćirić and Djurović (n 2) 322.

[8] More about the concept and types of foreign direct investment vision: Njegoslav Jović, 'Značaj pravne sigurnosti za ulaganje patentirane tehnologije od strane stranih investitora u BiH' in International Scientific Conference *Pravna sigurnost kao pospješujući faktor za direktne strane investicije* (Faculty of Law, University of Kragujevac 2016) 139-142.

[9] Jelena Stanojević and Darko Dimovski, 'Uloga pravne države u privlačenju stranih direktnih investicija' in International Scientific Conference *Pravna sigurnost kao pospješujući faktor za direktne strane investicije* (Faculty of Law, University of Kragujevac 2016) 76.

[10] Demir Firat and Su Li, 'Total Factor Productivity, Foreign Direct Investment, and Entry Barriers in the Chinese Automotive Industry' (2016) 52 Emerging Markets Finance & Trade 302, 303.

General rule is that foreign investors are attracted to legal systems which are predictable and efficient; and second, that it is possible to identify a uniform set of characteristics which render any legal system predictable and efficient.[11]

Bosnia and Herzegovina is a complex country consisting of two entities - Republic of Srpska and Federation of Bosnia and Herzegovina. This constitutional arrangement is established on the basis of the General Framework Agreement for Peace in Bosnia and Herzegovina known as the Dayton Peace Agreement, which was agreed at the peace conference held from 1-21. November 1995 in Dayton and signed on 14 December 1995 in Paris.

BiH has adopted its national legislation and ratified international agreements that regulate this field due to protect foreign investments and intellectual property rights, which are suitable for trade as the subject of foreign investment. Thus, in the field of foreign investment in 1992 was ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States from 1965. Also, BiH ratified the Convention on the Multilateral Investment Guarantee Agency from 1985. Taking into account national legislation in BiH, the Constitution is protecting the right to property and private capital. BiH adopted Foreign Direct Investment Act in 1998 and Foreign Trade Policy Act of BiH also regulate this area, as well as Investment Funds Act of RS and Investment Funds Act of FBiH, and numerous bylaws.

According to Article 2 of Foreign Direct Investment Act in BiH[12] foreign direct investment is an investment in a newly established commercial company or investment in existing domestic business organization, as well as investments in newly established institution or existing facility, which may be in cash, goods and rights. Accordingly, the subject of foreign investment could become objects of real estate law and intellectual property rights. Foreign investor is a natural person who is not national in BiH and who does not have its principal place of business in BiH or legal entity established in accordance with international law and having their

[11] Amanda Perry, 'An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality' (2000) 15 (6) American University International Law Review 1627, 1628, see <http://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1294&context=auilr> accessed 6 Jun 2017.

[12] Foreign Direct Investment Policy Act in BiH 1998 (BiH).

registered office, central administration or principal place of business in a foreign country.

A foreign investor can invest or reinvest profits from previous investments in any sector of the economy of Bosnia and Herzegovina under the same conditions as national of BiH. There are only restrictions for companies engaged in the production and sale of arms, ammunition, explosives for military use, military equipment and public information. In these company, foreign investors must receive prior approval from the competent authority and foreign investment cannot exceed 49% of the equity share or voting rights of such company.

According to Article 10 of Foreign Trade Policy Act of BiH[13] trade in goods that represent the investment of capital by foreign legal and physical persons or increase the role of the capital, except for goods whose import is subject to special restrictions, is free if it complies with the legal transaction based on which the investment is made.

Foreign investments are registered in accordance with the procedure of registration of business entities in BiH or its Entities and Brčko District. Upon completion of the registration courts ex officio deliver to the Ministry of Foreign Trade and Economic Relations information on registered companies with an element of foreign investment.

According to Article 8 of Foreign Direct Investment Act in BiH foreign investors have the same rights and obligations as national of BiH. This means that they are recognized under national treatment. Foreign investors will not be discriminated in any form, including but not limited to their citizenship, address or residence, religion or state of origin of investment. Foreign investment will be exempted from customs duties unless otherwise is provided by law.

Foreign investors in BiH are allowed to open accounts in commercial banks, to freely convert domestic currency, to transfer profit abroad that has occurred as a result of their investment in BiH. They have to maintain business books and prepare financial statements in accordance with the laws of BiH as well as with internationally accepted accounting and auditing standards. Foreign investors have property rights to real estate in BiH. However, foreign investors must respect the laws and regulations of BiH. Also, restrictions exist for domestic investment in public ancestor, public health and environmental protection, and they apply to foreign investors.

[13] Foreign Trade Policy Act of BiH 1998 (BiH).

Protection of foreign investment is regulated under Article 16 of Foreign Direct Investment Act in BiH which stipulates that foreign investments will not be nationalized, expropriated or requisitioned, and subject of measures with similar effects, except in the public interest and in accordance with applicable laws and regulations and with the payment of appropriate compensation. This compensation must be adequate, efficient and fast.

Foreign Direct Investment Act in BiH contains a stabilizing clause. Stabilization clause is a provision in the contract between the state and the investor or the norm of investment legislation which obliges the host State to subsequent changes in legislation, which is valid at the time of conclusion of the contract, shall not apply to the contract.[14] Thus, Article 19 of Foreign Direct Investment Act in BiH stipulates that the entry into force of this Act, the provisions of laws and regulations relating to foreign direct investment in BiH and which are contrary to or not in accordance with this Law shall cease to apply without violation of the rights and privileges that are given to foreign investors and the obligations imposed on them on the basis of previous laws and regulations. However, a foreign investor may declare in writing within 120 days from the date of entry into force of this law that he wants to apply the provisions of the new law. This article contains a stabilizing clause in the form of "freezing" of procedures from the time of conclusion of the contract with respect to foreign investors, which means that changes in the law does not affect its previously acquired rights. Article 20 of the Act prescribes the stabilization clause which guarantees the rights of foreign investors for investments executed under this law. It provides legal certainty and predictability of BiH regulations for foreign investors.[15]

According to the Central Bank of Bosnia and Herzegovina for the period from 1994 to 2013, the total foreign direct investments in BiH amounted about 11 billion BAM. In 2013, these investments amounted BAM 418.5 million and if we compared it with 2012 it represents a decrease of investments by about 21.6%. The biggest obstacle to foreign direct investment is political and legal uncertainty. BiH is in 87th position out of 148 countries in the world when it comes to competitiveness.

[14] Aleksandar Ćirić and Predrag Cvetković, 'Stabilizaciona klauzula u državnim investicionim sporazumima kao instrument zaštite stranih investitora' (2005) 42 Pravo i privreda 713, 717.

[15] See Jović (n 8) 145-147.

According to the World Bank report on business opportunities in 2013 BiH took 126th place out of 185 countries, which shows that BiH is the lowest ranked country in the region.

In the period from 2005 to 2014 in the Republic Srpska on the first place are investments from Serbia in which dominate investments in telecommunications (Telekom purchase). In second place are investments from Russia, which relate to investment in Oil Refinery Brod and Modrica oil refinery. In third place are investments from Slovenia, which consist of several investment projects (metal industry, banking and trade). In fourth place are investments from the United Kingdom relating to investments EFT mine and thermal power plants Stanari, while the fifth investment comes from Austria and mainly related to banking.

According to data from District commercial courts in the Republic of Srpska which are based on formal registration of foreign companies and their core capital by the respective courts in 2014 foreign direct investment in the Republic Srpska for the period from 1 January to 30 September 2014 amounted BAM 178.9 million as compared to 2013, in which the value of these direct foreign investment totaled BAM 136.6 million, representing a slight increase of these investments.[16]

The effects of foreign direct investment into the Republic Srpska and Bosnia and Herzegovina in general, despite a relatively stable legal framework, have not reached the expected level. The reason for this low level of foreign investment and in terms of volume and quality of investment is in fact there is a relatively low level of political and legal security. This uncertainty is reflected in the fact that even after more than 20 years of entry into force and implementation of the Dayton Peace Agreement, there is a high level of political tensions that accompany the internal structure of BiH authorities.[17]

Operational risks are usually analyzed by the index of economic freedom. BiH in 2015 had a value of the index of economic freedom 59, an improvement of 0.6 points compared to the previous year. Among 178

[16] Foreign direct investment in BiH: Existing barriers and the necessary steps (Frontal 5 Decembar 2014) <http://www.frontal.ba/novost/75599/strane-direktne-investicije-u-bih-postoje?e-prepreke-i-nuzni-koraci> accessed 2 Jun 2017. See also Vitomir Popović, 'Direktne strane investicije u Republici Srpskoj i Bosni i Hercegovini' in International Scientific Conference *Pravna sigurnost kao pospješujući faktor za direktne strane investicije* (Faculty of Law, University of Kragujevac 2016) 19.

[17] Popović (n 16) 20.

ranked countries BiH is on 97th place. Credit rating of BiH is followed by two agencies: Moody's Investors Service and Standard & Poor's. On the request of the Government of the Republic of Srpska agency Standard & Poor's for the first time did the credit rating for the Republic of Srpska and evaluated to "B3 stable outlook."[18]

3.2. Copyright protection technology in BiH

In 2010 BiH adopted Copyright and Related Rights Act, which repealed Copyright and Related Rights Act in Bosnia and Herzegovina from 2002. The new law is modern and compliant with European Union regulations. It is in the spirit of civil law legal system.

Article 1 of the Act provides that it regulates the right of the author to his works in the field of literature, science and art (copyright), right of performers, phonogram producers, film producers, broadcasting organizations, publishers and producers of databases to their performances, phonograms, videograms, broadcasts and databases (related rights), as well as the implementation and protection of copyright and related rights. These rights have BiH national or foreigners if it is determined by an international treaty, the law or material reciprocity.[19]

Technology that foreign investors want to invest in BiH is usually protected by patent or trade secret protection, or may contain copyright protection.

The Act contains specific provisions and prescribes the protection of computerized programs. According to Article 102, paragraph 1, and 3 of the Law on Copyright and Related Rights, a computer program is a program in any form, including preparatory material for its creation. It is protected as a work of authorship constitutes own intellectual creation of their author. The problem with using a computer manikin program of foreign investors in BiH lies in the excessive use of pirated programs. The state itself does not implement adequate copyright protection because in their own institutions use pirated programs. In that way, violates of copyright holders rights. So BiH encourages individuals within its territory to behave in the same way.

Violation of intellectual property rights, even by the state itself, and the lack of law enforcement leads to uncertainty in the market in the legal system and undermines confidence in business operations. Supply chains

[18] See ibid 21.

[19] See Copyright and Related Rights Act 2010 (BiH), art 175, para 2.

are becoming "contaminated" counterfeit goods. Consumers are not sure about that kind of behavior is appropriate and whether the goods they buy is legal and safe.[20] Enforcement of intellectual property rights is a key link to boost the economy, create jobs and improving the exports. Intellectual property supports activities in the fields of industry, particularly where there is a lot of creativity, research and innovation.[21] Obviously, the value of innovation will decline sharply if the innovations that have been developed by an individual or a company, can be copied or multiplied without restriction and without compensation by another company or a foreign country. The development of most modern economic innovation, especially in the field of technology, usually requires highly educated personnel, modern equipment and good business organization.[22]

BiH in its internal legal system must provide copyright protection of investors. Such an obligation is assumed by signing and accession to international treaties. The legislation is adequate, but in practice it is not applied and does not provide a sufficient guarantee for successful investment companies. Restrictions on the exercise of judicial independence from political influence discourage foreign investment. In the area of copyright protection BiH must improve judicial protection, since the current one far from adequate.

3.3. Patent protection, protection technology through trademark and other industrial property rights in BiH

BiH harmonizes its national law to the European Union and the World Trade Organization, ratified international conventions and conducted an audit of its legislation in the field of industrial property rights. When it comes to the patent rights, BiH ratified in the 1992 Paris Convention for the Protection of Industrial Property, in 1996 ratified the Agreement on cooperation in the field of patents, in 2004 ratified the Agreement between the Council of Ministers and the European Patent Organization on cooperation in the field of patents (Agreement on cooperation and Extension), in 2008 ratified the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent

[20] Dijana Janković, 'Zaštita intelektualne svojine – pravni i investicioni efekti' in International Scientific Conference *Pravna sigurnost kao pospješujući faktor za direktne strane investicije* (Faculty of Law, University of Kragujevac 2016) 90.

[21] ibid 91.

[22] ibid 96.

Procedure, in 2008 ratified the Strasbourg agreement concerning the international Patent classification and in 2012 ratified the Patent Law Treaty. Currently, it is valid in BiH, Patent Act of 2010 and the bylaws, the Rules of Procedure for the recognition of patent and consensual patent in 2010 and the Decision on the implementation of customs measures for the protection of the rights of the patent holder in 2012. By adapting its legislation, BiH has adopted the highest international standards for patent protection.

When it comes to the trademark law is ratified, inter alia, Protocol relating to the Madrid Arrangement Concerning the International Registration of Marks from 1989, the industrial design has ratified the Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs, in the field of integrated circuit topography rights Treaty intellectual property for integrated circuits, in the area of geographic origin has ratified the Lisbon treaty on the protection of Appellations of origin and their international registration, as well as other conventions.[23]

In 2010 BiH carried out a complete reform of industrial property rights. As part of this reform, they have been adopted a new Patent Act, Trademark Act, Industrial Design Act, the Law on the Label of Geographical Origin, the Law on Protection of Topographies of Integrated Circuits and the Law on the Protection of New Varieties of Plants in BiH. This BiH legislation reform in the field of industrial property rights has been partly sponsored by the European Union. Team of experts worked on the EU project "Capacity Building for the protection of intellectual property rights in BiH". This project and the proposals arising from it were the basis for the adoption of new laws. At the time of the adoption of these laws, they were fully compliant with the rules of EU. BiH now needs only to follow the change of the EU legislation and to be harmonized with it.

The term of technology to be understood, the manufacturing process and the process of organization and production management with the improvement of existing production levels. Technology can occur in two forms. First, technological knowledge that represents a collection of data, information about new inventions and processes of production, or as a collection of material creation the human mind. Second, appears as

[23] List of conventions ratified by BiH are available on the website of the Institute for Intellectual Property BiH <http://www.ipr.gov.ba/sr/stranica/medjunarodne-konvencije-ugovori_sr> accessed 4 Jun 2017.

objectified technological know-how covering the production factors such as industrial equipment, machinery, and which are necessary in one cycle of production and the workforce which is highly specialized in handling these machines for the rational use of material and the particular manufacturing process. These forms of technology are essential factors for obtaining the final product.[24]

Transfer of technology that is under patent protection is only possible with the consent of the patent holder, including the contracting of traffic rights to use the technology[25] (usually the license agreement). Although much of the technology that is still in use today is not under patent protection, most companies are not able to apply this technology because it requires knowledge that they do not possess. Accordingly, technology transfer is by the introduction to the present invention therefore a need to acquire and related knowledge without which it is possible to apply the present invention in the manufacture.[26] The technology that is protected as a trade secret is a risky and very easily can become available to other businesses. By detecting and publication of this technology in any way, the holder loses exclusive knowledge. If such technology is protected by patent it provides greater security to its holder and he alone has the exclusive right to use it.[27]

In 2010 BiH reformed its legislation on intellectual property rights. By adopting a new one Patent Act,[28] stopped to vaild the Law on Industrial Property in Bosnia and Herzegovina[29] to patents. This law is a modern and harmonized with EU regulations and is in accordance with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) adopted in the framework of the World Trade Organization and governing the entire subject matter of intellectual property rights.

This law regulates the legal protection of invention patent and consensual patent or patent granting procedure and the award of a consensual patent. Thus recognized patent is territorially limited to the territory of BiH. Article 4 is provided for national treatment. Foreign natural and legal persons regarding the protection of invention patent and

[24] Vesna Besarović, *Pravni aspekt prenosa tehnološkog znanja u zemlje u razvoju* (Savremena administracija 1978) 10.

[25] Slobodan Marković, *Patentno pravo* (Nomos 1997) 32.

[26] ibid 32.

[27] See Jović (n 8) 142-143.

[28] Patent Act 2010 (BiH).

[29] Law on Industrial Property in Bosnia and Herzegovina 2002 (BiH).

consensual patent in BiH enjoy the same rights as domestic natural or legal person, if it results from international treaties and conventions acceded to or ratified by BiH or from the application of the principle of reciprocity. However, foreign natural and legal persons are limited to taking action before the Institute for Intellectual Property, while in other cases must have an authorized representative who is entered in the Register of patent attorneys.

According to Article 25 of the Law to any natural or legal person in a Member State of the Paris Union for the Protection of Industrial Property, or the Member State of the World Trade Organization, submit application for the same invention recognize the priority right in Bosnia and Herzegovina, if requested within twelve months from the date of filing of the first application.

A patent may be the subject of a full or partial transfer of rights, as well as the subject of the license agreement. Transfer of rights and licenses have effect against third parties from the date of registration in the Register of Patent Applications and the Register of Patents. The Act also contains provisions on the international application under the Agreement on Cooperation in the Field of Patents and the provisions of the expansion effect of the European patent.

According to data from the Institute for Intellectual Property of BiH[30] in the period from 1993 to 2015 in Bosnia and Herzegovina was filed a total of 5125 patent applications of which 1,352 applications filed directly Institute, 1861 application filed submitted on the basis of the Agreement on Cooperation in the Field of Patents and applications 1912 European patents to which they are submitted to claims subtitle in accordance with an extension agreement with the European Patent Organizations Munich. Of the total number of filed applications, nationals have filed 903 applications and foreign citizens 2310 applications. Based on European patent applications, 1912 applications were submitted. According to these data of natural and legal persons, submit applications in 80% of cases.

The invention that is protected by a patent or which is an integral part of the technology, which is also composed of both inventions under the patent protection are suitable for investment in industry. This investment

[30] Document - Statistical indicators of the Institute for Intellectual Property in this paper are the answer Institute at the request of the author (*The Institute for Intellectual Property of Bosnia and Herzegovina* 2016).

can be in the form of a license agreement or investing funds in domestic inventions inventors to their inventions could be economically exploited. License agreement is made constitutive transport of industrial property rights, which means that from a subjective industrial property rights performs one or more economic rights which, as a new subjective right, constitute the name of the acquirer of the license.[31]

4. Conclusion

Protection of foreign direct investment is achieved by ensuring the implementation of standards such as the principle of equity, the principle of national treatment, most favored nation principle, the principle of equality, stabilization and revision clause and others.[32] The most important forms of guarantees that are established in an objective sense, the free transfer of the proceeds of sale of shares in the company, dividends, interest or other charges, undisturbed enjoyment of acquired rights in the event of changes in regulations and fair compensation in case of nationalization.[33] This protection the state can provide to its national legislation or acceptance of international protection of foreign investment.

Only the state that provides effective legal protection and adequate legislation and mechanisms for its implementation can create an environment for economic growth and development. Foreign direct investment as a constitutive element of the GDP and a generator of economic growth[34] and good judicial protection can attract foreign direct investment.

Foreign investments have significant economic implications for the country in which invest. The receiving State investments involved in international trade by increasing exports and this addition of fresh investment capital from abroad includes new technology that may be subject to patent protection, as well as managerial skills and experience.

[31] Slobodan Marković and Dušan Popović, *Pravo intelektualne svojine* (Faculty of Law, University of Belgrade 2013) 235.

[32] Aleksandar Ćirić, 'Pravna zaštita stranih investitora' (2007) 44 Pravo i privreda 361, 363.

[33] Sanja Grajić - Stepanović, 'Ka adekvatnosti pravnog tretmana i zaštite inostranih ulaganja' (2009) 46 Pravo i privreda 521, 529.

[34] Maša Alijević and Aida Mualić, 'Konstitucionalni okvir direktnih stranih ulaganja u Bosni i Hercegovini i pravni rizici' in International Scientific Conference *Pravna sigurnost kao pospješujući faktor za direktne strane investicije* (Faculty of Law, University of Kragujevac 2016) 351.

Foreign investment can be divided into direct investments, portfolio investments and mixed investments. Direct investment can be further divided into new investment (greenfield) investments by acquiring and acquisitions (mergers and acquisitions) and joint ventures. The technology that is under patent protection is similar to being subject to foreign investment. Most often this technology is the subject of mixed investment and direct investment, while portfolio investments are not eligible for a marketing technology under patent protection for its subjects.

Investments in intellectual property rights in modern times are one of the most expensive but also the most profitable investment. For this reason, every country that cares about the technological developments in national legislation provides adequate protection to foreign investors in intellectual creativity.[35]

Bosnia and Herzegovina as one of the countries in transition has an interest to attract foreign investors and investments to strengthen its economy and be more competitive in the international market. In that sense, BiH has acceded to international conventions that regulate the field of international foreign investment, but has also adopted its national legislation in this matter. When it comes to intellectual property rights, BiH also joined the international multilateral and bilateral conventions and has adopted its own internal laws in this field with the bylaws that accompany its implementation. BiH would undertake an active role that foreign investors and investments ensure a favorable investment climate and ensure legal certainty in terms of its national legislation in the field of foreign investment and protection of intellectual property rights in line with international standards.

BiH needs to increase foreign direct investment in addition to the adopted legislation, to take an active role and to provide adequate legal protection. In addition to judicial protection, the BiH political elite must not be corrupt. Otherwise, the rights provided by the laws of Bosnia and Herzegovina will be a "dead letter" and foreign investors will focus their investments to the countries that allow them to provide a safe and satisfying expected profit.

[35] Zoran Miladinović, 'Zaštita investicija u intelektualnu svojinu u Srbiji' (2007) 44 Pravo i privreda 608, 618.

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Short biography of the author

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The Codification of the Implied External Powers Doctrine and the EU-Singapore Free Trade Agreement

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Abstract: On 16 May 2017, the Court has released Opinion 2/15 on competence issues concerning the EU-Singapore Free Trade Agreement. Focal points of it were TFEU provisions codifying main elements of the Court's earlier case-law related to the implied external powers doctrine. The issues raised by the Opinion offer the opportunity not only to examine the development of this international law doctrine within the practice of the Court and the legal framework of the EU but also to reveal the future method of the Union regarding the conclusion of free trade agreements.

Keywords: implied external powers, EU external relations, free trade agreements, international agreements, Treaty of Lisbon.

1. Introduction

Concerning the relationship of international organizations to other actors of international law, the so-called *implied (external) powers* doctrine emerged in the practice of the Permanent Court of International Justice, and has been further developed by the International Court of Justice, mostly in cases related to the United Nations. The doctrine has been applied also by the European Court of Justice since the 1970s, which extended it with new elements regarding the international treaty-making competences of the European Economic Community and its successors.

There has been a change in the application of the doctrine in the EU legal environment, since the Treaty of Lisbon, which re-regulated the competence system of the European Union and its Member States, has incorporated articles into the Treaty on the Functioning of the European Union[1] (hereinafter TFEU) concerning the conclusion of international treaties and exclusive EU competences which sought to codify the main elements of the Court's case-law. However, it resulted hybrid solutions;

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[1] Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C202/47.

Articles 216(1) and 3(2) TFEU have taken different elements from previous judgments and opinions which may have a negative impact on the subsequent case-law of the Court.

The relevance of this study is based on the importance of *Opinion 2/15*[2], in which the Court made substantial conclusions on the competence issues arising in the context of the EU-Singapore Free Trade Agreement (EUSFTA) in relation to that doctrine and the Articles aiming to codify it. This examination will show not only the evolution of the role of implied external powers within the EU's legal framework but it also highlights fundamental issues that may be decisive in relation to whether or not the European Union can conclude such trade agreements states alone or with its Member States.

2. Implied external powers doctrine in the practice of ECJ – main junctions, with special regard to the later codification

2.1. The *ERTA* judgement

From the point of view of the subsequent development of the related case-law, the most significant conclusions have been laid down in the so-called *ERTA* case[3]. The antecedent of the case was the signing of the agreement concerning the work of crews of vehicles engaged in international road transport[4] in 1962 under the auspices of the United Nations Economic Commission for Europe, which, however, did not enter into force in the absence of a sufficient number of ratifications. Negotiations started to revise the agreement in 1967, and legislative frameworks were also developed within the framework of the EEC.[5]

Result of the codification was council Regulation (EEC) No 543/69 on the harmonisation of certain social legislation relating to road transport[6]. It has been essential that its legal basis was Article 75 of the Treaty establishing the European Economic Community (hereinafter TEEC, now

[2] Opinion of 15 May 2017, 2/15, EU:C:2017:376.

[3] Judgment of 31 March 1971, *Commission v Council*, 22/70, EU:C:1971:32.

[4] ERTA: European Road Transport Agreement or AETR: Accord Européen sur les Transports Routiers.

[5] Dale S. Collinson, 'The Foreign Relations Powers of the European Communities: A Comment on *Commission v. Council*' (1971) 23 SLR 956, 957–958.

[6] Council Regulation (EEC) No 543/69 on the harmonisation of certain social legislation relating to road transport [1969] OJ Spec Ed/170.

Article 91 TFEU), on which the Community transport policy was based authorizing the institutions to adopt 'appropriate provisions'.[7] In the light of the work carried out in the European Economic Committee, the Council discussed the position of the Member States in the negotiations at their meeting of 20 March 1970, which acted accordingly. The European Economic Commission opened the agreement for signature on 1 July 1970.[8]

On 19 May 1970, the Commission applied for the annulment of the Council's decision of 20 March. It argued that Article 75, which is the legal basis for common transport policy, allows not only the adoption of internal rules binding for the Member States, but also applies in external relations. In its view, the definition of *appropriate provisions* in Article 75(1)(c) TEEC is also applicable to international treaties with third countries.[9] On the other hand, the Council held that Article 75 TEEC could only result the adoption of internal rules, and the conclusion of international treaties does not follow from that, since such agreements can only come from express provisions of the Treaty.[10]

In its reply, the Court departed from Article 210 TEEC laying down the *legal personality* of the EEC. He explained that, since this rule was in Part Six 'General and Final Provisions', it is also applicable to the *objectives* within Part One of the Treaty. He stressed that the Community's ability to conclude international agreements should be examined throughout the whole system of the Treaty. Such capacity may, in addition to the explicit provisions, arise from *other rules* of the Treaty and from the *measures adopted* by the Community institutions.[11]

The significance of the abovementioned points is that the European Court of Justice followed similar logic like the International Court of Justice two decades earlier in its Advisory Opinion delivered in case *Reparation*

[7] Ildikó Bartha, *Nemzetközi szerződések mozgásban: Alkotmányos és nemzetközi jogi kihívások az Európai Unió külkapcsolataiban* [International Treaties on the Move: Constitutional and International Law Challenges within the External Relations of the European Union] (Dialóg Campus 2015) 60.

[8] Collinson (n 5) 959–960.

[9] Judgment 22/70, paras 6–8.

[10] ibid paras 9–10.

[11] ibid paras 13–16.

for injuries suffered in the service of the United Nations[12]. Both judicial forums considered legal personality as a 'threshold', something that must be fulfilled for the exercise of certain competences under international law.[13] Although the different nature of the TEEC resulted additional outcomes in the reasoning of the ECJ, since, besides the application of the implied external powers doctrine, it also coupled capacities coming from express competences with the legal personality.[14]

Another essential element of the judgment concerned the emergence of these specific powers of the EEC. The Court has held that whenever the Community adopts *common rules* in any form whatsoever for the purpose of implementing a common policy, the Member States may *not*, *individually* or *collectively*, assume any obligations vis-à-vis third States which may *affect* those rules. From that point onwards, the Community *alone* will be in a position to make commitments to third countries. As regards, the implementation of Treaty provisions, internal Community rules cannot be separated from external relations.[15] All this led to the conclusion that the existence of implied external competences is conditional upon the Community *having already exercised* at least its power to adopt internal rules.[16]

In addition, the judgment cited Article 3(e) TEEC, which contained the Community's *objectives* in establishing a common policy on transport and linked it with the principle of *Community loyalty* (now loyal cooperation, Article 4(3) TEU[17]), which required the Member States to fulfil obligations arising from the Treaty and the institutional acts, and to refrain to endanger the Treaty objectives. It follows that, in the context of the Community rules adopted to attain those objectives, the Member States

[12] *Reparation for injuries suffered in the service of the United Nations, Advisory Opinion: I.C. J. Reports* 1949, 174.

[13] Jan Klabbers, 'The Concept of Legal Personality' (2005) 11 Ius Gentium 35, 49–53.

[14] Judgment 22/70, para 16. Cf Klabbers noted that the Court has started to examine legal personality after it determined that there are no express Treaty provisions to conclude international agreement in field of transport policy. Klabbers (n 13) 54.

[15] Judgment 22/70, paras 17–19.

[16] Marise Cremona, 'The Doctrine of Exclusivity and the Position of Mixed Agreements in the External Relations of the European Community' (1982) 2 OJLS 393, 395.

[17] Consolidated version of the Treaty on European Union [2016] OJ C202/13.

cannot undertake any obligations which might affect those standards or, the Court inserted a new element, *alter their scope of application*.[18]

The above setting of the implied external competences has had significant implications for the international treaty-making practice of the EEC and its successors. As it is apparent from the Court's conclusions, the application of the doctrine simultaneously constituted the existence of the competence to conclude agreements without an express provision of the Treaty and the *exclusive* nature of that power.[19] This extended interpretation of the implied external powers doctrine, as Alan Dashwood called the '*ERTA* effect',[20] has proved to be decisive in relation to the perceptions of the Communities', and later the Union's, treaty-making competences and the subsequent practice of the European Court of Justice.

2.2. Opinion 1/76 and the related case-law

The subject-matter of *Opinion 1/76*[21] was the draft agreement establishing a European laying-up fund for inland waterway vessels. The primary purpose of the treaty was to compensate shipmasters from that statutory fund who temporarily decommissioned their vessels in accordance with the evolution of market demand.[22] According to the draft, in addition to the European Economic Community, the agreement involved not all but six Member States who were parties either to the revised Mannheim Convention of 1868 for the Navigation of the Rhine or to the Luxembourg Convention of 1956 for the Canalization of the Moselle, and Switzerland.[23] As the agreement affected the decision-making and judicial powers of the Community institutions, the Commission had previously asked the Court for its opinion on the draft.

In its opinion, the Court first considered the existence of the Community's external competence to conclude the agreement based on Articles 74-75 TEEC establishing the common transport policy. Recalling

[18] Judgment 22/70, paras 20–22.

[19] Bartha (n 7) 61.

[20] Alan Dashwood, 'Mixity in the Era of the Treaty of Lisbon' in Christophe Hilion and Panos Koutrakos (eds), *Mixed Agreements Revisited: The EU and its Members States in the World* (Hart 2010) 360.

[21] Opinion of 26 April 1977, 1/76, EU:C:1977:63.

[22] Piet Eeckhout, *EU External Relations Law* (2nd edn, OUP 2012) 78.

[23] Opinion 1/76, para 6.

the *ERTA* judgment, it reiterated its finding that the Community's competence to conclude agreements may not originate solely from the express rules of the Treaty, but implicitly from other provisions of it. This was particularly true for cases where the Community institutions *had already exercised their internal powers* with a view to achieving a common policy.[24]

New element of the opinion was that it has not limited the determination of external competences to this eventuality. It meant that the involvement of Switzerland, a non-Member State, was indispensable for its proper functioning, which was only possible through the conclusion of an international treaty.[25] Accordingly, the Court has held that the EEC may also assume an international obligation vis-à-vis third States where the Treaty permits the adoption of internal rules on such matters and its participation in an international treaty is *necessary* for the attainment of a Community objective.[26]

Due to the content of the agreement, the Court applied the implied external competences to other areas besides treaty-making powers. On the basis of Article 75(1) (c) TEEC authorizing the Community to adopt 'appropriate measures' within the framework of the common transport policy, the Court also concluded that the EEC may establish an *appropriate body* similar to that fund and undertake the implementation of *joint decisions*.[27]

The participation of those six Member States in the agreement, which were contracting parties to the Rhine and Moselle Conventions as well, also raised questions. The Court emphasized that the reason for the involvement of the Member States in question is that certain commitments contained in the two Conventions hinder the operation of the system of the agreement, and therefore the repeal of the undertakings concerned is necessary. It pointed out that the agreement would only have *legal effects* for the Member States *through the participation of the Community*. Since the six Member States would be participated in the

[24] ibid paras 3–4.

[25] Bartha (n 7) 62.

[26] Opinion 1/76, para 4.

[27] ibid para 5. On the development of the related case-law, see Inge Govaere, 'Beware of the Trojan Horse: Dispute Settlement in (Mixed) Agreements and the Autonomy of the EU Legal Order' in Christophe Hilion and Panos Koutrakos (eds), *Mixed Agreements Revisited: The EU and its Members States in the World* (Hart 2010) 190.

agreement merely to amend their former conventions, this should not be considered as an interference with the Community's external competences.[28]

Consequently, the Court added another element to the implied external powers doctrine. From that time onwards, the adoption of internal rules was not a prerequisite to the conclusion of an international agreement, but the existence of a competence and that this is 'necessary' for the attainment of one of the *objectives* of the Union were sufficient. At the same time, when considering this conclusion, it is also important to take into account the circumstances of the case, according to which an international treaty is the only means whereby those objectives could be satisfactorily attained.

The opinion does not contain a clear wording on the Union's exclusive competence to conclude an agreement, which has led to different opinions in literature.[29] The majority rejects exclusivity, inter alia by claiming that these are contained in the *ERTA* judgment, according to which this is the case when international treaties of the Member States are affecting common rules or altering their scope.[30]

In its subsequent practice, the Court clarified the above.[31] In *Opinion 1/94* on the 1994 Marrakesh Agreement establishing the World Trade Organization (WTO), it examined a number of issues related to the implied external powers doctrine. Concerning the General Agreement on Trade in Services (GATS), while recalling Opinion 1/76, it concluded that in such cases external competences can be exercised without internal rules, which thus become *exclusive*.[32] For this 'anticipated ERTA effect' the conclusion of the international treaty itself is the exercise of competence, which also leads to exclusive Union competence.[33]

On the other hand, later it confirmed that the requirement of necessity to conclude international treaties is sufficient only in special cases. *Opinion 2/92* was about competences related to the adoption of an OECD

[28] Opinion 1/76, paras 6–7.

[29] See Bartha (n 7) 65.

[30] Eeckhout (n 22) 81.

[31] Based on the summary by Robert Schütze, 'Federalism and Foreign Affairs: Mixity as a (Inter)national Phenomenon' in Christophe Hilion and Panos Koutrakos (eds), *Mixed Agreements Revisited: The EU and its Members States in the World* (Hart 2010), 78-79.

[32] Opinion of 15 November 1994, 1/94, EU:C:1994:384, para 85.

[33] Schütze (n 31) 78.

decision, and the Court laid down that such an agreement can be concluded if the Treaty objective cannot be achieved by adopting autonomous (internal) rules.[34] In the so-called '*Open Skies*' judgments it pointed out[35] that the Union enjoys *exclusive* competence in cases where the attainment of the internal objective is 'inextricably linked' to the conclusion of an agreement, and the exercise of internal competence can only be effective with the simultaneous application of external competences.[36]

2.3. Opinion 1/03

In *Opinion 1/03*[37] the Court has examined the question as to whether the European Community has exclusive competence to conclude the new Lugano Convention aiming to replace the 1988 Lugano Convention on jurisdiction and the enforcement of judgments in civil and commercial matters. The purpose of the 1988 Lugano Convention was to establish a system substantially in line with the Brussels Convention of 1968 on jurisdiction and the enforcement of judgments in civil and commercial matters between the Member States of the European Free Trade Association and the European Community, except for Liechtenstein.[38]

The reform of the Lugano Convention has become necessary, since the Treaty of Amsterdam resulted new Community competences in field of civil matters and judicial cooperation, and the Council Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters[39] (the so-called Brussels I Regulation) has been adopted.[40]

[34] Opinion of 24 March 1885, 2/92, EU:C:1995:83, para 32.

[35] Ildikó Bartha, 'A beleértett külső hatáskörök problémájának bemutatása az Európai Bíróság esetjogán keresztül' [Problem of Implied External Powers in the Case Law of the European Court of Justice] (2005) IX (3) Collega 33, 35–36.

[36] Judgment of 5 November 2002, *Commission v Germany*, C-476/98, EU:C:2002:631, paras 87–88.

[37] Opinion of 7 February 2006, 1/03, EU:C:2006:81.

[38] Opinion 1/03, paras 17–18.

[39] Council Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2001] OJ L12/1.

[40] Opinion 1/03, para 22.

The Court recalled its case-law on the implied external powers,[41] and, referring to the *Open Skies* judgments,[42] it listed the conditions for exclusive external Community competences.[43] It noted, however, that, in addition to these, there are *several cases* of exclusive Community competences,[44] so the list contains merely examples.[45] It was important to lay down the *purpose* of exclusive Community competences, which was found in the *effective application of Community law* and in ensuring the *proper functioning of the system* established by the Regulation.[46]

Departing from that, he considered the conduct of an analysis necessary to decide whether a Community competence *exists* to conclude an international agreement and it is *exclusive*. The Court emphasized that it is important to examine not only the *subject-matter* of Community law and the agreement to be concluded,[47] but also the *nature* and *content* of the provisions concerned should be analysed with special regard to the related rules to be adopted.[48]

Applying this to the new Lugano Convention, it stated that it clearly affects the subjects covered by the Brussels I Regulation, especially since the same system is being developed by the two legal sources.[49] In the context of the other two aspects, it stressed that the Regulation was intended to create a 'comprehensive and coherent' system of rules to avoid conflicts of jurisdiction and to recognize and enforce judgments which would be 'affected' by some of the proposed provisions of the new Lugano Convention.[50]

The (adverse) *affect* should be understood in the light of the *ERTA* judgment, which defines the exclusive competence of the Community. The Court also recalled paragraph 17 of that judgment which says that after

[41] ibid paras 114–126.

[42] Judgment of 5 November 2002, C-467/98, EU:C:2002:625, paras 81–84.

[43] ibid para 45.

[44] ibid para 121.

[45] Bart Van Vooren and Ramses A. Wessel, *EU External Relations Law: Text, Cases and Materials* (CUP 2014) 124.

[46] Opinion 1/03, para 131. See Marise Cremona, 'Disconnection Clauses in EU Law and Practice' in Christophe Hilion and Panos Koutrakos (eds), *Mixed Agreements Revisited: The EU and its Members States in the World* (Hart 2010) 184.

[47] Opinion 1/03, para 133.

[48] Eeckhout (n 22) 110.

[49] Opinion 1/03, paras 142 and 152.

[50] ibid paras 148, 168 and 172.

the introduction of common Community rules, "the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which *affect* those rules."[51] As the ERTA judgment and the related case-law showed, the category of agreements 'jointly' concluded by the Member States meant primarily *mixed agreements* involving them and the Community. Consequently, the Court held that the Community had exclusive competence to conclude the new Lugano Convention.[52]

Another new elements of the opinion were the findings on the so-called *disconnection clause*,[53] related to the previous ones.[54] On a proposal from the Council, the clause in the new Lugano Convention states that "the agreement *does not affect* the application by the Member States of the relevant provisions of Community law".[55] The Commission considered the application of the formula to be unnecessary because of the full harmonization, and since such provisions are subjects of mixed agreements, the insertion of it can be seen as the Council's 'clumsy attempt' to justify the participation of the Member States, besides the Community, in the new Convention.[56]

Nor did the Court considered the disconnection clause as sufficient safeguard but rather an evidence for affecting Community rules.[57] It stated that incorporation of such a clause does not in itself imply the existence of that affect and does not relieves of the conduct of the said investigation.[58] It accepted the Commission's view that in this case not the delimitation of the new Lugano Convention and the Brussels I Regulation is the aim, but the coherent regulation of the relationship between the two laws. It found the clause also problematic for the reason that it contained *exceptions* which made it more likely that Community rules might be affected.[59]

[51] ibid para 44, emphasis added.
[52] ibid para 173.
[53] See Cremona 'Disconnection Clauses' (n 46) 160.
[54] Van Vooren and Wessel (n 45) 123.
[55] Opinion 1/03, para 130, emphasis added.
[56] ibid paras 93–84.
[57] ibid para 130.
[58] ibid paras 129–130. Cremona 'Disconnection Clauses' (n 46) 182–183.
[59] Opinion 1/03, paras 155–160.

In Opinion 1/03 the Court not only gave conclusions of general nature on the implied external powers but it developed the doctrine further. This is especially true for the *purpose* of exclusivity, which can serve as a benchmark for areas other than the conclusion of international treaties. By referring to the cases of implied external powers as mere *examples* of the '*ERTA* effect', it also *opened the doctrine* to further development.[60]

3. Implied external powers after the Treaty of Lisbon

3.1. Codification of the doctrine within the TFEU

During the drafting process of the Treaty of Lisbon, which reformed the European Union's founding treaties, great emphasis was placed on making EU's action at international level more efficient through creating a more coherent legal framework for external relations. The fifth part of the TFEU deals with the external action of the European Union and Title V contains the competences and procedures for the conclusion of international treaties. One of the measures intending to codify the implied external powers doctrine is Article 216(1) TFEU, stating that:

> "The Union may conclude an agreement with one or more third countries or international organisations where the Treaties so provide or where the conclusion of an agreement is necessary in order to achieve, within the framework of the Union's policies, one of the objectives referred to in the Treaties, or is provided for in a legally binding Union act or is likely to affect common rules or alter their scope."

In addition to the first element, which refers to the Treaty measures expressly authorizing the conclusion of international agreements, the paragraph contains three cases of implied powers when the last two turns are taken as one.[61] Article 216(1) TFEU is intended to codify the main conclusions of the *ERTA* judgment and the related case-law, particularly

[60] Eeckhout (n 22) 112.

[61] Like the literature does, see Marise Cremona, 'Defining competence in EU external relations: lessons from the Treaty reform process' in Alan Dashwood and Marc Maresceau (eds), *Law and Practice of EU External Relations: Salient Features of a Changing Landscape* (CUP 2008) 56.

as regards the first turn referring to the *objectives* of the Union as set out in the Treaties. However, while the judgment links the goals with the existence of common rules, the text does not, it merely refers to EU policies. According to the grammatical interpretation, this text would, by its very nature, significantly broaden the Union's competences for international treaty making, but in any event it relieves the link between the existing competences of internal and external competences, which was an essential part of previous judicial practice.[62]

The second element is referring to provisions of *legally binding Union acts*. This turn is the closest to the conclusion of the *ERTA* judgment, according to which the power to conclude international agreement may also come from 'measures adopted' by the institutions.[63] The wording, however, raises questions in the light of the system of legal instruments under the Treaty of Lisbon.[64] Accordingly, (binding) acts are one secondary law adopted during the legislative procedure,[65] but also includes *delegated acts* of the Commission and *implementing acts* of the Commission or by the Council.[66]

The last turn is an essential element of the abovementioned *ERTA* effect, since if Member States could conclude international treaty in relation to the area already governed by EU law, those agreements could adversely affect these common rules or alter their scope. The problem is that, in the judgment, this was not only the basis for the conclusion of an agreement but as a prerequisite for the Union's *exclusive competence* to do so.[67] Inserting this item to the implicit powers reinforces the assumption that exclusive external competences can only be exclusive but not shared with Member States.[68] This is contrary to the decade-long practice of the Court, which recognizes both exclusive and shared treaty-making powers.[69]

[62] Cremona 'Defining competence in EU external relations' (n 61) 57.
[63] Judgment 22/70, para 16.
[64] Arts 288-289 TFEU.
[65] Art 289(3) TFEU.
[66] Arts 290-291 TFEU.
[67] Cremona 'Defining competence in EU external relations' (n 61) 58.
[68] Robert Schütze, 'Lisbon and the Federal Order of Competences: A Prospective Analysis' (2008) 33 European Law Review 709, 713, quoted by Van Vooren and Wessel (n 45) 107.
[69] See Opinion 1/03.

The other relevant article is located in Part One ('Principles'), under Title I ('Categories and areas of Union competence') of the TFEU. Article 3(1) TFEU lists the areas in which the European Union has exclusive competence to regulate; these are the customs union, the establishing of the competition rules necessary for the functioning of the internal market, monetary policy for the Member States whose currency is the euro, the conservation of marine biological resources under the common fisheries policy and the common commercial policy. Article 3(2) TFEU lists cases which do not fall within the scopes above, but result exclusive competence as well:

> "The Union shall also have exclusive competence for the conclusion of an international agreement when its conclusion is provided for in a legislative act of the Union or is necessary to enable the Union to exercise its internal competence, or in so far as its conclusion may affect common rules or alter their scope."

What is apparent at first reading is the similarity between Article 216(1) and Article 3(2) TFEU. This is surprising because the former was intended to contain the exclusive and shared and the latter only the exclusive EU competences.[70] The first turn is similar to Article 216(1) TFEU, but while there is a legally binding act as a basis for international treaty making, Article 3(2) TFEU governing exclusive competences contains *legislative act*. The wording of the more stringent requirements that exclude non-legislative acts can be understood in the light of the comparison with the other provision, since in the latter case only the Union can conclude international treaties afterwards. Both elements derive from the 'measures adopted' phrase of the *ERTA* judgment,[71] but the distinction based on the types of acts is a new element of the codification. At the same time, the wording of the turn reveals the consequences of ignoring shared competences. Under this rule, a legislative act adopted in the area of shared competences will also give rise to exclusive external competence of the EU.[72]

[70] Eeckhout (n 22) 113.
[71] Judgment 22/70, para 16.
[72] Schütze (n 68) 713.

The next case when the conclusion of international agreements is *necessary* to enable the Union to exercise its internal competence, which is the main conclusions of Opinion 1/76,[73] but can also be considered to be stricter than the Union's objectives within Article 216(1) TFEU.[74] As the analysis of the given opinion has shown, it did not explicitly stated that the Union has exclusive competence in such cases, this broad interpretation is based on Article 1/94 by saying that external powers could be exercised – and thus become exclusive – without the adoption of internal rules.[75] The third turn contains again conclusions of the *ERTA* judgment, which was examined earlier, establishing exclusive Union competences.[76]

The wording of Article 3(2) TFEU is also surprising for the reason that the Court has already defined three cases of exclusive competences in the *Open Skies* judgments.[77] The only common item of the two lists are *legislative acts* prescribing the negotiation and conclusion of international agreements, otherwise they contain different elements of the related case-law.[78] However, this contradicts to Opinion 1/03 which states that these are merely *examples* and that the specificities of cases have been essential in drafting the conclusions.[79]

Already in the period after the entry into force of the Treaty of Lisbon, the Court concluded that, since Article 3 (2) was based on the *ERTA* judgment and the related case-law, the rule has to be interpreted in the light of those sources.[80]

[73] Van Voren and Wessel (n 45) 107.

[74] Eeckhout (n 22) 113.

[75] Opinon 1/94, para 85.

[76] Judgment 22/70, paras 17 and 22.

[77] These are the cases of internal legislative acts „relating to the treatment of nationals of non-member countries or expressly conferred on its institutions powers to negotiate with non-member countries", or „the Community has achieved complete harmonisation in a given area, because the common rules thus adopted could be affected within the meaning of the *AETR* judgment if the Member States retained freedom to negotiate with non-member countries." Judgment of 5 November 2002, C-471/98, EU:C:2002:628, paras 96–97.

[78] Van Voren and Wessel (n 45) 106.

[79] ibid 106, Opinion 1/03, para 121.

[80] Judgment of 4 September 2014, *Commission v Council*, C-114/12, EU:C:2014:2151, paras 65–67, see Ildikó Bartha, 'Mérlegen. Az Európai Unió külső tevékenységének lisszaboni reformjai' [On the Scale. Lisbon Reforms of the European Union's External Actions] (2015) XV (3) Európai Jog 1, 5.

The biggest mistake of the 'summary codification'[81] aiming to record the implied external powers of the European Union is that it incorporates the related case-law in an incoherent manner, thus the provision confuses the cases of *existence* and *exclusivity* of the competences.[82] The wording gives the impression that the implied external powers can only be exclusive and therefore do not take into account the specificities of the areas of shared competence.[83]

3.2. Opinion 2/15 and the conclusion of EU-Singapore Free Trade Agreement

One of the most important elements of the case-law[84] related to these renewed treaty provisions is Opinion 2/15 of 16 May 2017 which dealt with the competence issues in relation to the free trade agreement between the European Union and the Republic of Singapore. As a result of the negotiations between 2010 and 2014, the draft treaty set out seventeen chapters on trade liberalization provisions. The Trade Policy Committee discussed the draft in 2015, where disagreement arose as to whether the conclusion of the agreement falls within the exclusive competence of the Union or shared with the Member States.[85]

In its request for an opinion, the Commission argued that the EU alone was entitled to conclude the agreement. Key element of its reasoning was that most of the regulated areas are subject to the common commercial policy, which is considered to be the exclusive competence of the Union, except for the *cross-border transport services* provided for in Chapter 8 and *investments other than direct investments* under Chapter 9, but pursuant to Article 3(2) TFEU codifying implied external powers, the Union may also enter into an international treaty on its own.[86]

[81] David Kleimann, 'Reading Opinion 2/15: Standards of Analysis, the Court's Discretion, and the Legal View of the Advocate General' (2017) EUI RSCAS 2017/23 <http://cadmus.eui.eu/bitstream/handle/1814/46104/RSCAS_2017_23REVISED.pdf ?sequence=4> accessed 25 October 2018, 33.

[82] Cremona 'Defining competence in EU external relations' (n 61) 61.

[83] Schütze (n 68) 713.

[84] See Bartha 'Mérlegen' (n 79) 5–6; Marise Cremona, 'Shaping EU Trade Policy post-Lisbon: Opinion 2/15 of 16 May 2017: ECJ, 16 May 2017, Opinion 2/15 *Free Trade Agreement with Singapore*' (2018) 14 EuConst 231, 247.

[85] Opinion 2/15, para 11.

[86] ibid paras 13–16.

The case, the opinions of Advocate General Eleanor Sharpston and of the Court nearly half a year later were pervaded by the question of how far the scope of the common commercial policy extends under the legal framework established by the Treaty of Lisbon.[87] According to the reformed provisions, this policy involves trade in services, commercial aspects of intellectual property and foreign direct investment.[88] The Court has stated in that regard that the mere fact that a Union act may have 'implications' for trade relations with non-Member States does not in itself mean that the provision falls within the scope of the common commercial policy.[89]

Concerning the implication of the implied external powers doctrine, the standpoints on transport services were of relevance, on the one hand. AG Sharpston and the Court reached different conclusions whether the EU has exclusive or shared treaty making competence in these cases. Following the analysis of the related secondary law – and using the formula from *Opinion 2/91*[90] – AG Sharpston has stated that, in case of rail and road transport, the common rules 'largely cover' the relevant area, so the EU has exclusive competence.[91] On the other hand, it did not consider harmonization of maritime, inland waterway and air transport issues to be sufficient, and thus established the existence of shared competence in these fields.[92]

Compared to the Advocate General's Opinion, the Court has found exclusive competence in more cases,[93] which was true for all aforesaid transport services. A special case was the air services, or rather services related to air services, for which the Court found that these were not transport but rather services within the meaning Article 207(1) TFEU governing the common commercial policy.[94] In the context of maritime,

[87] Cremona 'Shaping EU Trade Policy post-Lisbon' (n 84) 238.

[88] Balázs Horváthy, 'A közös kereskedelempolitika alapelvei és célkitűzései az integrált uniós külkapcsolatrendszer tükrében' [Principles and Objectives of the Common Commercial Policy in the Llight of the Integrated Union External Relations] (2014) 10 (1) Iustum Aequum Salutare 51, 64–65.

[89] Opinion 2/15, para 36.

[90] Opinion of 19 March 1993, 2/91, EU:C:1993:106, para 25.

[91] Opinion of Advocate General Sharpston, delivered on 21 December 2016, opinion 2/15, EU:C:2016:992, paras 256 and 264.

[92] Opinion 2/15, AG Sharpston, paras 241–242, 245–246 and 250–251.

[93] Cremona 'Shaping EU Trade Policy post-Lisbon' (n 84) 236.

[94] Opinion 2/15, paras 61–68.

rail, road and inland waterway transport, the Court considered the overlap between common rules and the agreement to of 'a large extent',[95] which gave reason to lay down exclusive competence in these fields as well.[96] In its reasoning, the Court already referred to its post-Lisbon case-law,[97] where *ERTA*-effect prevailed even if Member States retained regulatory competences. It has done so with a view that „the meaning, scope and effectiveness" of the common rules „may be affected".[98]

Other types of issues were raised by measures on non-direct foreign investments. While *foreign direct investment* means the establishment of a lasting and direct link between the investor and the company involved,[99] the so-called *'portfolio' investment* is the purchase of company securities for investment purposes without the intent to influence the management or control the undertaking.[100]

In case of foreign direct investment, it was not difficult to determine the Union's exclusive competence, since Article 207(1) TFEU lists this subject as element of the common commercial policy.[101] In accordance with Article 3(1)(e) TFEU, the EU has exclusive competence in this field, and therefore is entitled to conclude international agreements alone with third countries on this matter.[102]

However, competence questions connected to portfolio investments meant to be a more complex problem. In the Commission's view, in this case, the last turn of Article 3(2) TFEU establishes the exclusive competence by allowing the envisaged agreement to 'affect' Article 63 TFEU establishing capital and payment transactions between Member

[95] ibid para 201.

[96] ibid paras 193, 202, 211 and 217.

[97] Judgment of 26 November 2014, *Green Network*, C-66/13, EU:C:2014:2399; Opinion of 14 February 2017, 3/15, EU:C:2017:114.

[98] Para 201. David Kleimann and Gesa Kübek, 'The Singapore Opinion or the End of Mixity as We Know It' (*VerfBlog*, 23 May 2017) <https://verfassungsblog.de/the-singapore-opinion-or-the-end-of-mixity-as-we-know-it/> accessed 30 October 2018

[99] Opinion 2/15, para 80.

[100] ibid para 227.

[101] The Court noted that „the words 'foreign direct investment' in Article 207(1) TFEU is an unequivocal expression of their intention not to include other foreign investment in the common commercial policy", para 83.

[102] Opinion 2/15, paras 81–82.

States and third countries. In its opinion, Article 63 TFEU constitutes a 'common rule' on the same legal basis.[103]

Advocate General Sharpston, like in case of transport services, did not examine the existence and then the exclusivity of the competence,[104] but, in line with the Commission's questions, generally analysed Article 3(2) TFEU,[105] and then in context with the given matters,[106] finally, she focused on the applicability of Article 216(1) TFEU.[107]

The analysis underlines the specificity of the regulation that, contrary to Article 3(1) TFEU, which contains a list of exclusive EU competences in general, paragraph 2 only refers to external competences.[108] She called the third turn dealing with agreements affecting common rules or changing their scope 'ERTA principle',[109] and sought to determine the steps of its application. Firstly, she considered to be necessary to define the *area concerned* by the international agreement's content and purpose, secondly to establish the relevant *common rules* and, thirdly, to examine the *impact* of that agreement on those rules. At the last element, citing the Court's practice, she stressed that it is sufficient for the obligations contained therein to fall within the scope of the common rules, so there is no need for a conflict between the two.[110]

She rejected the Commission's argument in respect of portfolio investments that the free movement of capital measures of the founding treaty would fall within the 'common rules' contained in the last turn of Article 3(2) TFEU. The questionable character of the provision was emphasized by the Advocate General stating that it does not provide with 'decisive guidance', and, referring to the *Commission v Council* judgment[111], she confirmed that it should be interpreted in the light of the *ERTA* judgment and the subsequent case-law.[112]

[103] ibid para 229.

[104] Neither did the Court, see Cremona 'Shaping EU Trade Policy post-Lisbon' (n 84) 246.

[105] Opinion 2/15, AG Sharpston, paras 117–132.

[106] ibid paras 346–361.

[107] ibid paras 363–370.

[108] ibid para 117.

[109] ibid para 121.

[110] ibid paras 123, 125 and 128.

[111] Judgment of 14 September 2014, *Commission v Council*, C-114/12, EU:C:2014:2151, para 67.

[112] Opinion 2/15, AG Sharpston, paras 350–352.

AG Sharpston emphasized that Article 3(1) TFEU deals with cases of express exclusive Union competences laid down by the Treaties, so that the elements in paragraph 2 must necessarily be *additional legal bases*. She further argued that the 'affect' or 'alter of scope' of Treaty provisions would in fact mean the *modification* of the Treaties to which Article 48 TEU only applies.[113]

The legal basis for the exclusive competence of the Union for the conclusion of international treaties was found, in relation to the provisions concerned, in the *impact* of the agreement on the common rules adopted.[114] However, in that context, she rejected the broad interpretation of the Commission.[115] Referring to earlier opinions of the Court,[116] she stated that the adoption of those rules means the *exercise* of the Union's internal powers, the mere existence of the latter does not constitute competences to conclude international agreements.[117] Since she has not found any secondary law for the portfolio investments but the free movement of capital Treaty provisions, she confirmed that the Union has no exclusive competence in this area.[118]

Regarding the fact that exclusive Union competence for portfolio investments could not be established, AG Sharpston considered, on the basis of the Commission's earlier raising, whether the second turn[119] of Article 216(1) TFEU on general treaty making powers of the Union is applicable in this case.[120] Essential element of her thinking was that Article 63 TFEU on the free movement of capital provides for *liberalization* between Member States and between Member States and third countries and, in the context of related secondary law, portfolio investments also fall within that scope.[121] It follows that the conclusion of an international agreement is *necessary* to achieve the objective of mutual liberalization between Member States and third countries. Given that Article 3 TFEU,

[113] ibid paras 353–354.

[114] ibid para 353.

[115] Kleimann (n 81) 34.

[116] Opinion of 24 March 1995, 2/92, EU:C:1995:83, paras 33 and 36; 1/94, EU:C:1994:384, para 77.

[117] Opinion 2/15, AG Sharpston, para 353.

[118] ibid paras 360–361.

[119] „where the conclusion of an agreement is necessary in order to achieve, within the framework of the Union's policies, one of the objectives referred to in the Treaties"

[120] Kleimann (n 81) 31–32.

[121] Opinion 2/15, AG Sharpston, para 367.

which governs exclusive competences, could not be applied, this part of the Opinion was closed with the conclusion that in accordance with Article 4(2)(a) TFEU, which defines *internal market* as *shared* competence, the EU and its Member States can jointly conclude this agreement.[122]

The Court came to the same conclusion as AG Sharpston, but the former's reasoning differed from the above. As reaction to the Commission's questions, the Court has thoroughly examined whether, in accordance with Article 3(2) TFEU, Article 63 TFEU constitutes such a *common rule* that would be affected if not only the Union concluded the agreement. Accepting the Council's, the Member States' and Advocates General's view, the Court has stated that these can only be secondary law, and the progressive adoption of them should be followed by the establishment of external Union competences in the same time to prevent the Member States to enter into international commitments. The extension of it to the primary law would undermine the reasoning of the *ERTA* judgment.[123]

The Court has also rejected the application of that rule to the Treaty provisions in the light of *primacy*. However, it has not referred to the relationship between EU law and the legal systems of the Member States, but that the *legitimacy* of EU legal acts derives from the Treaties, so it is *conceptually excluded* that international agreements, as such acts, may affect or alter the scope of Treaty articles.[124]

In addition to the Commission's point, the Court has also examined whether the Union has exclusive competence to conclude the portfolio investments parts of the FTA on the basis of the other two turns of Article 3(2) TFEU. Without going through a thorough research, it concluded that, in the case of such matters, the conclusion of an international agreements is not required by any *legislative act*, nor is it *necessary* to exercise the Union's internal competence.[125]

Like the Advocate General's opinion, after analysing the cases of exclusive EU competences, the Court dealt with Article 216(1) TFEU authorizing the EU to conclude international agreements, more specifically with its second turn containing the requirement of *necessity*.

[122] ibid paras 369–370.
[123] Opinion 2/15, paras 233–234.
[124] ibid para 235.
[125] ibid paras 236–237.

The related Treaty objective was found in the realization of the free movement of capital, which belongs to the field of internal market and, as such, within the meaning of Article 4(2)(a) TFEU forms shared competence.[126] On this basis, the Court has concluded that the provisions on non-direct foreign investments could not be approved by the Union alone.[127]

As will be seen below, it was only indirectly linked to the implied external powers doctrine, but the competence issues on *investor-state dispute settlement* (ISDS) was of great importance regarding treaty making powers for the whole FTA. While dispute settlement in case of the Comprehensive Economic and Trade Agreement (CETA) between Canada and the EU means an investment court system (ICS), the EU-Singapore Free Trade Agreement contains measures on arbitral tribunal.[128]

Concerning similar *institutional* rules, in line with its earlier practice, the Court has generally held that they are of *ancillary nature* meaning that these are governed by the competence rules of the related substantive provisions.[129] However, opinions of the Advocate General and the Court differed on dispute settlement system under the EUSFTA.[130] Reflecting the complementarity character of those rules, the Advocate General confirmed the general principle cited, according to which these rules do not alter the distribution of powers between the Union and the Member States.[131] On the other hand, in the Court's opinion, the regulation of this type of procedure could not be considered to be *purely ancillary* as it *excludes* disputes *from the jurisdiction of the Member States*. This necessitates the consent of the Member States, which entails shared competence between the Union and the Member States to resolve this issue.[132]

[126] ibid paras 239–241.
[127] ibid para 243.
[128] Cremona 'Shaping EU Trade Policy post-Lisbon' (n 84), 255.
[129] Opinion 2/15, para 276.
[130] Cremona 'Shaping EU Trade Policy post-Lisbon' (n 84), 255.
[131] Opinion 2/15, para 529.
[132] ibid paras 292–293. See Laurens Ankersmit, 'Opinion 2/15 and the future of mixity and ISDS' (*European Law Blog*, 18 May 2017 <https://europeanlawblog.eu/2017/05/18/opinion-215-and-the-future-of-mixity-and-isds/> accessed 25 October 2018

In its final conclusions, the opinion did not give a categorical response to the Commission's question of whether the Union has 'adequate powers' to conclude the agreement,[133] but instead answered the questions which areas are governed by exclusive or shared EU or exclusive Member State competence.[134] As the last case has not existed, it looked like this treaty should be concluded as a so-called *facultative* mixed agreement. The category drawn up by Allan Rosas refers primarily to international treaties which subjects belong to either purely shared or partially exclusive and partly shared competences, but individual elements cannot be separated. In such cases, it is up to the Council (or the Member States) to decide whether the Union alone or with the Member States will conclude the agreement.[135]

The above was confirmed by the relevant practice of the Court.[136] The *Germany v Council* judgment[137] referred to Opinion 2/15, according to which portfolio investments fall within shared competence between the Union and the Member States. It should be noted that „in making that finding, the Court did no more than acknowledge the fact that, as stated by the Council in the course of the proceedings relating to that Opinion, there was no possibility of the required majority being obtained within the Council for the Union to be able to exercise alone the external competence that it shares with the Member States in this area."[138]

It is an obvious shortcoming of the opinion that it did not specify a Treaty provision for ISDS that could serve as a legal basis for shared competence.[139] Instead, it merely stated that that procedure „removes disputes from the jurisdiction of the courts of the Member States."[140] In addition, as mentioned earlier, the Court rejected the purely ancillary

[133] Kleimann and Kübek (n 98).

[134] Opinion 2/15, para 1.

[135] The other is the case of the so-called *obligatory* mixed agreements, where areas of the treaty fall within exclusive Union and other areas within exclusive Member State competences. See Allan Rosas, 'Mixed Union – Mixed Agreements' in Martti Koskenniemi (ed), *International Law Aspects of the European Union* (Kluwer 1998) 128–133; Ankersmit (n 131).

[136] Cremona 'Shaping EU Trade Policy post-Lisbon' (n 84) 251–252.

[137] Judgment of 5 December 2017, *Germany v Council*, C-600/14, EU:C:2017:935.

[138] ibid para 68.

[139] Kleimann and Kübek (n 98).

[140] Opinion 2/15, para 292.

nature of the relevant provisions,[141] which, in principle, would mean that dispute settlement cannot be governed solely on the two legal bases used for the types of investment. Although the opinion is silent on it, this implies the exclusive competence of the Member States where, in the context of a subject, this and the Union's competences cannot be separated from one another. According to the quoted literature, these features could have resulted either an *obligatory* mixed agreement with the Member States, or different international treaties on trade and investment matters.[142]

Nearly a year after the Opinion was released, on 18 April 2018, the European Commission presented its concept on the future of the EUSFTA, which contained proposals for two international agreements. One document concerned the conclusion of a free trade agreement between the EU and Singapore,[143] in which the Union alone appeared as contracting party, and the other was the agreement on investment protection with the participation of the Union and its Member States, so as mixed agreement.[144] In line with the foregoing, the Council adopted on 15 October 2018 two decisions[145] authorizing the conclusion of the two international treaties.[146] This solution seems to be exemplary, since on

[141] ibid.

[142] See Szilárd Gáspár-Szilágyi, 'Opinion 2/15: Maybe it is time for the EU to conclude separate trade and investment agreements' (European Law Blog, 20 June 2017) <https://europeanlawblog.eu/2017/06/20/opinion-215-maybe-it-is-time-for-the-eu-to-conclude-separate-trade-and-investment-agreements/> accessed 25 October 2018.

[143] European Commission, 'Proposal for a Council Decision on the signing, on behalf of the European Union, of the Free Trade Agreement between the European Union and the Republic of Singapore' COM(2018) 197 final.

[144] European Commission, 'Proposal for a Council Decision on the signing, on behalf of the European Union, of the Investment Protection Agreement between the European Union and its Member States, of the one part, and the Republic of Singapore of the other part' COM(2018) 195 final.

[145] Council Decision (EU) 2018/1599 on the signing, on behalf of the European Union, of the Free Trade Agreement between the European Union and the Republic of Singapore [2018] OJ L267/1; Council Decision (EU) 2018/1676 on the signing, on behalf of the European Union, of the Investment Protection Agreement between the European Union and its Member States, of the one part, and the Republic of Singapore, of the other part [2018] OJ L279/1.

[146] Besides, the contracting parties concluded a partnership and cooperation agreement, also as a mixed agreement. Council Decision (EU) 2018/1047 on the signing, on behalf of the Union, of the Partnership and Cooperation Agreement between the European Union and its Member States, of the one part, and the Republic of Singapore, of the other part [2018] OJ L189/2.

proposals from the same day concerning the relationship with Japan,[147] the economic partnership agreement was concluded,[148] and negotiations on the separate investment protection agreement were still ongoing when this paper was closed.[149]

4. Conclusion

Although the Treaty of Lisbon has made EU external relations indeed more coherent than these were before, but the codification of the implied external powers doctrine into the TFEU does not belong to the successful elements of the Treaty reform. The 'summary' fixing of the items from the Court's judgments and opinions resulted that these rules can only be interpreted in light of the related case-law. This also means that the list appearing to be closed by its wording merely contains the main cases, and the possibility remains open to further extension.

Since the entry into force of the two provisions, Opinion 2/15 was not the first case in which the Court had to face their applicability, but it emerged from the others because of the complexity of the issues raised. With regard to the doctrine of implied external powers, the significance of the Opinion is coming from the fact that the Court has interpreted it broadly and narrowly within a single case. While contrary to the Advocate General's opinion, it found exclusive Union competences for transport services even if EU rules only 'largely covered' these fields, but rejected the EU-alone treaty making power for portfolio investments. The limitation of the meaning of common rules to secondary law paradoxically resulted that the implied external powers doctrine did not extend but limited the European Union's international law competences in this case.

The case has highlighted the hinges of this type of agreements, but the Opinion did not provide clear guidance as to how EU institutions and Member States need to respond to these. It is apparent from the dispute settlement section that, concerning this borderline issue of Union and

[147] European Commission, 'Proposal for a Council Decision on the signing, on behalf of the European Union, of the Economic Partnership Agreement between the European Union and Japan' COM(2018) 193 final.

[148] Council Decision (EU) 2018/966 on the signing, on behalf of the European Union, of the Agreement between the European Union and Japan for an Economic Partnership. OJ L174/1.

[149] European Commission, 'Key elements of the EU-Japan Economic Partnership Agreement' MEMO/18/6784.

Member State competences, the Court intended to leave the question open. It neither established exclusive Member State competence, nor underpinned shared Union competence with any application of the implied external powers doctrine. All this allowed the 'two agreements' approach, proposed by the Commission, which seemed to be as a compromise from both Union and Member States perspectives, and ultimately proved to be acceptable to the Council.

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From Warehousemen to Terminal Operators

Viktória Kovács *

Abstract: The present paper examines the work of the International Institute for the Unification of Private Law (UNIDROIT) and the United Nations Commissions on International Trade Law (UNCITRAL) in connection with United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (OTT Convention) and the necessity of the regulation in international level. The legal regulation relating to the work at warehousing was not uniform until the year of 1960, especially in question of liability. UNIDROIT and UNCITRAL dealing with judicial aspects of international commerce initiated preparation of a Convention covering this aspect.

Keywords: convention, warehousing, liability, transportation, terminal operator

1. Introduction

After the development of technologic and logistic structures (1980), local activities became prominent in the chain of the transportation of goods, as well as the related questions of liability.

The transportation of goods can be divided into two distinct categories. Firstly, the carriage of goods, secondly, the handling of goods before, during or after the transit. As to the carriage of goods, this subject had been regulated by international conventions or national laws as compared to the handling of goods, especially the liability. On the basis of international practice it can be said that there was a lack of uniform rules relating to the liability of warehousemen (terminal operators) who perform transport related services[1] during the course of international carriage.

The importance of the regulation of these operations and the related questions of liability is emphasized by international statistics that show that damage/loss does not occurs most often during the actual carriage but before or after transit.

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[1] Such as loading, unloading, storage, stowage, trimming, dunnaging or lashing.

In these circumstances it seemed important to try to fill the gaps in the liability regime. Firstly, the UNIDROIT and later the UNCITRAL started preparatory work on the OTT Convention on the basis of need for harmonization and modernization.

The OTT Convention is based on the work of UNIDROIT on the topic of bailment and warehousing contracts, which was adopted as the preliminary draft Convention on the Liability of Operators of Transport Terminals by the UNIDROIT Governing Council in 1983.

The present paper examines the work of the UNIDROIT and the UCITRAL in connection with the OTT Convention and the necessity of the regulation in international level.

2. Background and aim of the Preliminary Draft Convention

The legal regulation relating to the work on warehousing was not uniform until the year of 1960, especially in question of liability. UNIDROIT and UNCITRAL dealing with judicial aspects of international commerce initiated preparation of a Convention dealing with this aspect.

It was in 1960 that the subject of bailment and warehousing contracts first appeared in UNIDROIT's work programme. At that time academics and others realised that there was a lack of uniformity in rules relating to the liability of non-carrying intermediaries who perform transport-related services during the course of international carriage.[2]

The preparation of uniform rules governing the warehousing contract was particularly difficult by the organization. The complexity of the problem was (that) customs and practices differed widely between one warehouseman and another. These differences (distinctions) were not only as regards the conduct of their operations but also in respect of the applied liability regime. Moreover, significant definitions were not exactly determined, like the meaning of long-term or transit warehousing.[3]

Notwithstanding these difficulties, there was a general observation that there is a real need for the introduction of uniform rules on warehousing contract, especially in the context of the international carriage of goods.

In this context the Secretariat of UNIDROIT requested the Governing Council to consider the possibility of the preparation of uniform rules on

[2] UNCITRAL, *Draft Convention on Liability of Operators of Transport Terminal sin International Trade: A critical commentary* (1989).

[3] Explanatory report prepared by the UNIDROIT Secretariat.

the contractual position of warehousemen who are handed over the goods during the course of a transport operation and the liability thereby incurred by them.

The work of UNIDROIT was based on the Preliminary report on the warehousing contract[4] by Dr. Donald Hill, senior lecturer in Law at Queen's University.

3. Regulation and liability of warehousemen

Warehousing is essentially a practical commercial operation in which the needs of national and international trade meet, because the international transportation of goods is rarely possible within one branch of means of transport. In practice the chain of transportation consists of several consecutive segments before the goods arrive at the final destination. Because of the complexity of the problem, every legal system must provide the regulation of warehousing operations. The various countries of the world can be divided into different judicial categories as regards the regulation of warehousing operations.

Firstly, common law regulates warehousing by the general provisions relating to the bailment of goods, secondly, provisions may be made in the civil or commercial codes governing the deposit of the goods generally.

As to the first category, there are countries which are subject to the common law. The United Kingdom is the principal example of this category, where legal system permits to complete freedom of contract in respect of warehousing contracts. Here there have been no statutory provisions governing the warehousemen's or terminal operator's liability.

At common law warehouseman is merely a bailee 'who as part of his business has care and custody of the bailor's goods'[5] and therefore the general rules of bailment[6] should be used for it. It means that warehousemen has to take all reasonable care of the goods and he is liable for loss or damage resulting from his own negligence or that of his

[4] In 1976.

[5] A. R. Carnegie, *Bailment and contract in English law today*.

[6] Bailment describes a legal relationship in common law where physical possession of personal property is transferred from one person (the 'bailor') to another person (the 'bailee') who subsequently has possession of the property. It arises when a person gives property to someone else for safekeeping, and is a cause of action independent of contract or tort.

servants. The rights and liabilities of the bailor are essentially based on a duty of reasonable care in relation to the goods.

Secondly, there are countries where warehousing is subject to statutory control. In these countries, like Germany, Belgium and the Netherlands, warehousing is subject to the continental civil law.

In the case of Germany, special provisions are made in respect of warehousing[7]. According to this regulation the warehouseman is 'liable for loss or damage to the goods unless this could not have been prevented by the care of a careful merchant'[8]. According to the German system, liability was limited to 20 marks per kilo unless a higher value has been declared.[9]

In Belgium warehousing is regulated by Code Civil, which lays down the liability of the warehouseman. According to the regulation, he is liable for loss or damage to the goods except on the proof of force majeure, but his liability may be limited by the use of general conditions of contract.[10]

In the Netherlands the Code Civile and the General Conditions for Storage, Safekeeping and Delivery of Goods also regulate the liability of warehouseman, which includes detailed conditions in respect of the liability of terminal operators.

Moreover there are countries where special laws govern different kind of warehouse keeper, such as bonded warehouses and warehouse warrants, but in most cases terminals have the right to promulgate their own regulations in respect of the handling of goods. These regulations should be approved of some higher authority, and they may have the force of law within their area of operation, or may only be considered as merely general conditions of contracts. In this respect Germany and the Netherlands are good examples, because in these countries general conditions of contract of warehousemen have tended to overlay the formal law.

4. From Warehousemen to Terminal Operators

The Preliminary report on the warehousing contract was transmitted by UNIDROIT to Government and organizations for observations on the

[7] Verordnung über Order-Lagerscheine 1931.
[8] Handelsgesetzbuch, § 390.
[9] Verordnung, § 19.
[10] Preliminary report on the warehousing contract.

feasibility of preparing uniform rules on the liability of persons other than the carrier for the custody of goods entrusted to them before, during or after transport operations.

Most of the European countries[11] supported the concept of uniform rules in this field, however the United States and the United Kingdom opposed the initiative, as the preliminary report did not deal with the definition of warehousing contract, warehousing operations or of the warehousemen. The report should distinguish warehousing from other operations, and it would be desirable to adopt some working definition or description of warehousing operations.

Another disputed question was in connection with the types of warehousemen namely, should any exclusion of application of the future rules exclude some type of warehousing, e. g. customs warehouseman or carrier is acting as a warehouseman.

In view of particularities of various modes of transport, should the future rules in warehousing operations apply without distinction in carriage of goods in all modes of transport (including multimodal transport) or should allowances be made for the differences between them?

It was questioned whether the future rules should extend to other aspects of warehousing contract such as the warehousemen's lien over the goods?[12]

In connection with definitions, a new determination was initiated in 1977. A German scholar[13] examined the importance of intermediaries at different modes of transport. He drew up the relative unimportance of intermediaries in connection with carriage by road, rail or air. He estimated that the most common use of intermediaries is in regard to carriage by sea.[14]

On the basis of this research Professor Ramberg[15] suggested that the term of „sea terminals" should be used in a broad sense, including all facilities ashore where goods are handled before or after the transport.

[11] Like Austria, Finland, France, Germany, Denmark, Norway.

[12] UNIDROIT 1977, Study XLIV – Doc. 3.

[13] Dr. Richter Hannes.

[14] UNIDROIT 1977, Study XLIV – Doc. 3.

[15] Professor Jan Ramberg who had been involved in the preparation of preliminary report on the subject of port terminals.

The aim of using this term to avoid any particular legal concept existing in various national laws[16] but rather get at the practical realities.

In 1978 the UNIDROIT Study Group met for the first time. In the first session the main subject of the agenda was the consideration of the feasibility of drawing up uniform rules on the warehousing contract in light of the preliminary report. At the first meeting the Group discussed the matter in general terms and laid down the bases. The Group agreed that the field of the convention should be extended to cover all operations between two different modes of transport.

The Group introduced the term of terminal operator who is a link in the chain between the carriers and the experts analysed what functions of terminal operators would be covered by the rules, e. g. merely warehousing or also those handling operations such as loading and unloading.

In the end it was agreed that the convention would cover the safekeeping of the goods by the operator but that he may undertake some ancillary services, too.

5. From Draft to Convention

The UNIDROIT preliminary draft Convention was transmitted to the UNCITRAL in 1983. The international organization decided to include the topic of liability of operators of transport terminals in its work programme.

In 1984, UNCITRAL assigned the Working Group on International Contract Practices to the task of formulating uniform legal rules on the subject and decided that the Working Group should base it work on the UNIDROIT preliminary draft Convention but should also consider any other relevant issues not dealt with by UNIDROIT.

The Working Group, which was composed of all member States of UNCITRAL, developed draft uniform rules over four sessions, the last being held in January 1988. After that the Convention was adopted on 17 April 1991. Until 30 April 1992, the deadline for signing the Convention, the following States signed it: France, Mexico, Philippines, Spain and the United States of America.[17]

[16] Such as e. g. the „basis" contract types mandatum, depositum, locatio operis.

[17] Explanatory note by the UNCITRAL Secretariat on the United Nations Convention on the liability of operators of transport terminals in international trade.

How Brexit Affects Labour Mobility? Free Movement of Employees in Context of the British Withdrawal

Dr Éva Nyerges*

Abstract: The British withdrawal, and its evidently uncertain outcome, arises several questions either from political or economic points of view. The free movement of persons is one of the main catalyst of European co-operation. Although it rises from the EU law as it can be considered as the most direct among principles of which effect can be mainly perceptible by society. In the current period, a lot of people are concerned with the question of what is happening to EU workers who are residing legally in Great Britain. Brexit can actually be a crossroad, not just for the United Kingdom, but for the whole European integration.

Keywords: labour mobility, Brexit, free movement of workers

1. Introduction

On summer 2016 a significant event shook global public opinion: UK citizens decided on a referendum that they do not want to belong to the European Union anymore. The beginning and the end of the event and procedure – labelled Brexit – would be difficult to determine. It is definitely sure, though, that both its reasons and its expected effects are in close relation with free movement of employees.

The British withdrawal and its evidently uncertain outcome arises several questions either from political or economic points of view. The connected statements and analyses predominantly approach the phenomenon from political and financial aspects, although it would be a mistake to forget the opinion of the EU inhabitants: *id est* the mostly affected subjects are EU citizens in the procedure leading to Brexit.

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2. Free movement of persons in the European integration

Analysing any matters in relation with the European Union, the four basic freedoms of the EU should be practically kept in mind. The four principles – namely free movement of goods, capital, services and persons – are all equally such disciples that are both goals and tools of the European integration at the same time.

The right of free movement of persons is naturally in connection with the other three freedoms since they create the principal and practical unity altogether that is one of the main catalyst of European co-operation. Although it rises somewhat from the other EU law as it can be considered the most direct among the principles of which effect can be mostly perceptible by society.

2.1. Free movement of workers or citizens? Two aspects of the principle

Free movement of workers was originally included in the Treaty mainly for economic reasons. The approach of the Treaty of Rome was explicitly aiming to urge active employee or entrepreneurial activity by ensuring free movement. The economic approach has slightly changed: the principle of free movement of persons was completed with a kind of social character. Social aims of free movement of employees – even rather citizens in general – came into prominence. The establishment of EU citizenship contributed greatly to it. The citizens of member states have the right to this status rooting from the Maastricht Treaty. Thus, it completes the unity revealed in legal, economic and living conditions, all this nowadays determines the position of citizens residing in EU member states.

Judicial practice has had great impact into making the principle of free movement of persons more complex with social aims by shaping it like a fundamental right: Court of Justice of the European Union (CJEU) explained the principle itself in its several decisions.

2.2 Legal framework of free movement of employees

Free flow of persons is therefore an EU fundamental right that still includes free movement of employees of which primary legal base is the Article 45 of Treaty of the Functioning of the European Union (TFEU)[1] that replaced Article 39 of the former Treaty establishing the European

[1] Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C202/47.

Community (TEC). Accordingly the free movement of employees has to be ensured inside the territory of the EU. Thus, EU citizens can move without either any restrictions or as per the Schengen Agreement any border control, possessing a type of official identification document if they stay not longer than 90 days in the given member state.[2]

The right of free movement of persons in the Union supported by primary and secondary law as well. This group of persons is further explained in the secondary law to whom this very principle relates beyond employees in general: such as self-employment, service providers and people involved in education.[3]

2.2.1 The prohibition of discrimination and its limits

The Treaty declares not only the right but the non-discrimination principle as well: it requires the elimination of any kind of differentiation among member state workers based on citizenship.

Prohibition of discrimination should be interpreted in a broader sense, since it is required regarding from recruitment to remuneration to other work and employment conditions. The principle of free movement of employees therefore represents the exclusion or termination of any discrimination relating citizenship when employment, work compensation, and creating any other related terms are considered. Although the principle excludes differentiation, it is not an absolute obligation; it can be limited to protect public policy, public security or public health. In this respect rights and protections provided by the EU legislation are not always unrestricted, the above mentioned concerns of a considerably high value namely pubic policy, security or health can limit the application of free movement of workers.

Nevertheless, the internal law of the member state cannot be negligible with the existence and characteristics of the above mentioned interests, thus, it should be considered by national law. In this respect, there is an important requirement for states to be consistent based on judicial

[2] András Gyertyánfy, 'Migráció, régiók, egységes piac: az Európai Unió keleti bővítése és a határon túli magyarok' [Migration, regions, single market: the Eastern enlargement of the European and the Hungarian diasporas] (2002) 13 (3) Regio 117, 119.

[3] Directive 2004/38/EC of the European Parliament and of the Council on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States [2004] OJ L158/77.

practice. The decision in the Adoui/Cornuaille case[4] cleared that the state can only reckon the specific threat – which meant in this Belgian case prostitution – if it considers the same deed relating to its own citizens as well. Outstanding significance of higher level values and interests is undebatable. It points out that integration is always surrounded as a kind of limitation by the sovereignty of a member state.

2.2.2. Personal scope of Article 45 – or who is to be considered an employee

First of all, it is crucial to note that the term *worker* does not always have the same meaning in the interpretation of member state law and that the EU law does not make any reference in this issue either.

According to the standpoint of the Court of Justice the employee is in this context an EU term and hence, the terms commonly used in member states' internal law are not applicable.[5] As for the above, the employee is an EU legal term with separate legal meaning that cannot be interpreted using the notions of member states' laws. Judicial practice created the criteria based on which it can be decided whether a given activity has to or can be considered *work* in sense of EU law.

Some of these criteria are in fact exact and of formal character while other aspects can be explicitly explained based on their content. It is relatively simple to determine formal requirements: an employment-like relationship is if a person performs services for and under direction of another person in return for which the employee receives remuneration (cf. Lawrie Blum case).[6]

Consideration based on content includes more subjective elements yet; in this context it is necessary to decide whether the work is both factual and real. The Court did not consider the activity as real work in the Bettray case, where the activity of work occurred in drug rehabilitation, but it considered the work conditions acceptable in Steymann. In this

[4] Judgment of the Court of 18 May 1982, *Adoui and Cornuaille*, joined cases 115 and 116/81, EU:C:1982:183.

[5] László Blutman, *Az Európai Unió joga a gyakorlatban* [The Law of the European Union in practice] (HVG-ORAC 2014).

[6] Judgment of 3 July 1986, *Deborah Lawrie-Blum v Land Baden-Württemberg*, 66/85, EU:C:1986:284.

latter case the work in religious community happened for food and lodging.

2.2.3. Enhancing Personal Scope and its exceptions

It is necessary to emphasize that the right of free movement is ensured for the citizens of member states.[7] Regarding the fact that the free movement of persons should be interpreted broadly, the EU law enhanced the principle of free movement to the persons seeking for a job.

Article 45 TFEU determines exactly the scope of the freedom, as it ensures the right – considering restrictions justified based on public order, security, health issues –, for the following:

- apply for actual job vacancies;
- move freely within the territory of all member states willing to apply for a job;
- reside in any member states with the aim of taking up a job, according to the laws and decrees; and
- after being employed in of the member states should stay in the territory of the given member state, according to the condition determined by the Commission decrees.

So the ensured right for free movement of employees expands to all the citizens who arrive to a member state explicitly for „place hunting." Nevertheless it is crucial to note that this right can be limited in time: in the United Kingdom, this period is six months.

It is important, that the Treaty establishes an exception from the scope of the Article 45. Public employment is out of authority of this provision. The principle of free movement of employees is not covered for people working in public employment because of the specifications of this public law; the institutional and functional characteristics basically distinguish different types of legal relationship (i.e. public sector) from typical jobs undertaken in private sector.

[7] Ernő Várnay and Mónika Papp, *Az Európai Unió joga* [Law of the European Union], (Wolters Kluwer 2016) 600.

3. Effects of Free Movement of Labour Force

It is no doubt that the phenomenon of labour migration has been steadily increasing in EU member states this decade. The willingness for undertaking a job has grown up that has a close connection to wage level in member states with high level economic indicators.

The nature of working in a foreign country is versatile; quite different life situations moreover life cycles are drawn up within employee migration in the EU. With respect to the planned time period there are significant differences since a lot of workers plan to settle down permanently while others consider work temporary in another member state. One should not forget in relation to upper cyclical work as in case of seasonal work it is common that after relatively long stay abroad either a shorter or a longer periods of staying at home follows.

Conversely, the aim of undertaking a job varies based on the he character of the work itself. A lot of employees go to given determined workplace or target country while others move away from their home country in a "linear way." It is not rare though that the employee – according to his/her opportunities – undertakes jobs in a changing method and sign a job contract in other member state. It can be seen that labour mobility within the EU does not only show an increase in quantity but in diversity: each person has their own idea about making a career far from their home country or having enough money for the given month.

3.1. Legal framework of employment in other member state

Working in EU member states is diverse in terms of legal framework resulting from the above described facts: another procedure prevails for "cross-border commuters" than for persons residing in another member states for an extended period.

The most relevant distinction consists of the fact whether the employee resides in any member state for more than three months. Union law deposes in a 2004 directive about the right of residence of EU citizens and their family members.[8]

EU citizens possessing a valid ID/passport have the right to enter any EU country together with their family members. They may stay for further three months after they entered another EU member state, without having to meet any conditions or formal requirements. Regarding the principle of

[8] Directive 2004/38/EC.

free movement of employees each and every EU citizen has the right to reside – even permanently – in the member state where he/she works. In case of a staying over three months it is not enough to possess a valid ID, but they have to register at the adequate authorities in the welcoming country.

For member states, the obligation of registration is prescribed by the above mentioned Directive. It is essential that the registration itself does not create the right, since this procedure is a simple report. Seasonal work and the above mentioned commuting that is typically but not exclusively characteristic in territories close to the border, do not make registration compulsory as long as the employee regularly, at least once a week returns to his/her own member state.

3.2. Labour force mobility after eastern enlargement

After the eastern enlargement EU states had to accept that not only the countries have joined the EU but persons as well.[9] The enlargement process of the EU itself raises several questions as the enlargement is mainly a phenomenon, which almost necessarily includes inner contradictions and requires balanced political communication. In the case of the eastern enlargement – which embraced the highest number of countries joining the EU during the enlargement – these aspects became even more accentuated.[10]

The legal, economic and political requirements of the prospective eastern enlargement were laid down by the European Council in Copenhagen in June 1993. *Nota bene*, the application for EU membership of Hungary has been submitted in 1994, first out of the ten CEE states wanting to join. Although the European Commission concluded that none of the three conditions – namely democracy and human rights, functioning market economy, and the harmonisation of EU and domestic law – were completely fulfilled, there was still an opportunity to join.

Square one of the eastern enlargement was considerably more difficult than the previous ones. It seemed to be a major economic challenge to integrate less developed (poor) countries into the internal

[9] László Andor, 'Munkaerő-mobilitás az EU-bővítés után' [Workforce mobility in the EU enlargement] (2014) 61 (4) Közgazdasági Szemle 363, 366.

[10] Péter Balázs, *Az Európai Unió külpolitikája* [The foreign policy of the European Union] (Wolters Kluwer 2016).

market of significantly developed (rich) member states.[11] Therefore there were some hidden risks – if returns and costs are at stake as well – compared to the previous enlargements. The consistent standpoint of the European Commission is that labour mobility makes a win-win situation for both the state of origin and the receiving country.[12] However economic advantages can probably be proved, other aspects of labour migration are still to be concerned.

Since 2004 both the volume and direction of migration have fundamentally changed: the number of workers coming from newly joined member states to western countries has significantly increased. In the case of the United Kingdom it is to be highlighted that recent immigration volume surpassed the forecast of the British government. According to the correspondence of The Guardian news portal's political column in 2017 about 3.3 million EU citizens coming from other member states reside officially on the British Isles and one million out of it lives in London.[13]

So, the UK had to face free flow of workforce at a higher level than expected and British complained several times about. Though common law would have ensured for the "old" member states the opportunity for introducing temporary restrictions, but the British decided to open the labour market to the EU workers coming from the new member states after the Eastern enlargement.[14] It is worth mentioning that the effectiveness of the at least 7-year-long restriction could have been or could be in reality contradictory.[15]

3.3. Labour migration inside the United Kingdom

If one would like to understand the British approach, it is necessary to acclaim that quite a lot of factors influenced the procedure resulting in the situation seen today. The British essentially show a low-level attachment to the continent; in their traditional approach the positive

[11] Dr Fritz Breuss, 'Az Európai Unió keleti bővítésének költségei és hozamai' (1998) 76 (9) Statisztikai Szemle 709.

[12] Andor (n 8) 366.

[13] <https://www.theguardian.com/politics/2017/mar/28/sadiq-khan-give-eu-citizens-cast-iron-guarantee-they-can-stay-in-uk>

[14] European Commission, 'The Transnational Arrangements for the Free Movement of Workers from the New Member States following Enlargement of the European Union on 1 May 2004' <ec.europa.eu/social/BlobServlet?docId=144&langId=en>.

[15] Andor (n 8) 365.

consideration of being different is vitally part of their identity.[16] Separation – characteristic in the UK – is apparently a factor that has an affect against unity, thus it does not favour integration efforts.

Within the wording of the notion commonly used in the European integration, the "reluctant partner" expresses the British opinion relatively right. A lot of articles and analyses call the UK as "reluctant partner" or in other cases "reluctant player"; though the generally accepted opinion considered broadly the brit representation in the EU useful.[17] During the accession talks and in its membership, the UK has always been individualistic. The Eurosceptic approach was present from both the government and the population; naturally different in its manifestation. This is obviously was mirrored in relation with the phenomenon of labour migration as well. It is a fact that the unforeseen budgetary impacts of considerable migration have been questioned by the British government even years ago.

Furthermore, the United Kingdom elaborated several scenarios to solve these worries, although huge number of EU migrants – in economic sense – is explicitly advantages for the state as for the GPD and budgetary indicators.[18]

The principle of free movement – as may be the most important freedom in this context – has become the central question of the membership of the UK. The possible restriction of free movement – at least based on the statements of British officials – was described even earlier, however its factual model, that would have left the EU membership along with the above mentioned constrictions, had not been realized.

Actual politics offered several possibilities, one of them was to stop migration like an "emergency brake"; and as a second opportunity was to introduce some limitations on social benefits. The latter was mentioned by David Cameron before the Brexit-poll, the referendum about leaving

[16] Éva Szilágyi 'Az Egyesült Királyság uniós politikájának dilemmái: integráció vagy elszigetelődés?' [Dilemmas of the UK's European policies: integration or isolation?] (2005) 8 (4) EU Working Papers 80.

[17] "Britain has always been rather half-hearted about the European Union…" The United Kingdom has been named as "The Reluctant European" in an article, see <http://www.economist.com/news/special-report/21673505-though-britain-has-always-been-rather-half-hearted-about-european-union-its>.

[18] Andor (n 8) 367.

the EU. It is worth mentioning these theories as they can become influential during future talks. The provision according to the first version would have been implemented by the state if the number of incoming migrants had surpassed a given level or if it turns apparent that in some sectors the migration employment pushes down salaries (or for specific trades).[19]

It can be seen that "the protecting mechanisms" have not been determined for their own sake; rather for such a situation in which economic risks influencing the member state are threatening sustainability.

4. Brexit: That's Great (!) Britain

Eligible voters of the United Kingdom on the 23rd o June 2016 voted for leaving the EU. Participation was relatively high as the 71.8 % of voters (30 million citizens respectively) went to the poll. On the contrary a slight difference determined the result. 51.9% of voters – that cannot be called significant – chose the leave the EU, so the majority does not wish to belong to the Union.

After the resignation of David Cameron, Theresa May was appointed to the prime minister of the United Kingdom; thus, it is her task to arrange the procedure of ceasing the EU membership. May announced a mid-term election for the 8th June 2017 with which she allegedly intended to strengthen her political position. The outcome of the election was not in line with her expectations: although she can remain in her chair, as the Conservatives had majority in the Parliament, the Party is forced to form a coalition with Northern Ireland's leading Democratic Unionist Party (DUP).

4.1. The planned procedure of Brexit

Regarding to the provisions of Article 50 of the Treaty on the European Union (TEU)[20], the withdrawal is a 2-year-procedure. The commencement of the procedure began with the notification from the United Kingdom on 29th March 2017. The series of talks, which intends

[19] Zuzanna Bobowiec, 'Brexit and Free Movement of People: The Frameworks and Legal Bases of Possible Migration Control' [2017] King's Journal for Politics, Philosophy and Law 105, 106–107.

[20] Consolidated version of the Treaty on European Union [2016] OJ C202/13.

to determine the rights and obligations regarding the withdrawal, should be completed by March 2019, the scheduled date of the expiry of the membership status. It is vital that the exit should be approved by all the 27 member states. While the membership still prevails, i.e. the exit is not completed, rights and obligations coming from the EU membership, remain in force.

4.2. Soft Brexit or Hard Brexit?

In connection with the exit – while writing the present paper – there are several questions to be answered. It is unclear, among others, what direction the supervision of earlier measures during harmonisation of law will take. In the law system of the UK, a lot of legal acts were implemented and it is a mystery what will happen to them.

The actual British politics, naturally, made up different recommendations to resolve it. The Bill of the Conservatives – Great Repeal Bill – would eliminate the supremacy of EU law. On the other hand, the Labour Party came up with a draft called EU Rights and Protections Bill, which would leave most of the EU law in the state's legal system. The latter legal solution, in addition to consumer rights, would leave workers' rights completely untouched, which certainly implies that both movement and nature of the workforce are considered to be kept in line with the EU legal framework.

Exit negotiations have not yet started at the time of the present paper, but there are several theories about its possible outcomes. In extreme cases, which the press and analysts identify as "Hard Brexit" – by the withdrawal the British government would also reject the workforce. According to this scenario, this would also be the case if this would result in the partial loss or even the total loss of the benefits provided by the common market. The Mayor of London pointed out that such a situation would result in a loss not only for the United Kingdom, but also for the other Member States.[21] The so-called "Soft Brexit" would mean a similar solution, which is followed by Norway and other members of the European Economic Area (EEA). In this model, even though the status of EU membership would not be maintained, Britain would remain within the economic area.

21 <https://www.theguardian.com/politics/2017/mar/28/sadiq-khan-give-eu-citizens-cast-iron-guarantee-they-can-stay-in-uk>

Reassessments are of course understandable, but with a realistic assessment of economic impacts, it would not be surprising if the United Kingdom sought a way out of the EU to preserve a certain level of economic benefits. This, in spite of all political debates and public opinion, includes free labour mobility. In fact, productivity can only be sustained with quantifiable and qualitative labour force, which cannot be ignored by the British government either.

4.3. (Expected) effects of the British exit

The economic impacts of Brexit and the expected impacts on economic indicators and relationships have raised rather lively debates among analysts. This paper is not subject to an economic evaluation, but it will certainly affect the world economy in addition to the United Kingdom.

The exit of the United Kingdom from the EU is indisputably closely linked to the free movement of labour. And there is not only an interaction between Brexit and the EU labour flow, but also in respect to the expected impacts.

As stated in her January 2017 statement, Theresa May, one of the most important messages of the referendum on the exit is that the British want immigration to decline and maintain it at a sustainable level. The citizens' message is clear from the referendum: Brexit means that it is necessary to control the number of people coming from Europe to Britain.[22] The downturn in the labour flow can now be accounted for almost a year, compared to the same period last year, with 49.000 fewer workers coming to the country.

4.4 Workers in the United Kingdom

In the current transition period, a lot of people are concerned with the question of what is happening to EU workers who are currently legally residing in Great Britain. The rights of EU citizens already living in the country are not to be undermined by London's official position, but they want to settle it with an agreement. Because of the nature of the relations between the states, this requires a reciprocal procedure: of course, with respect to British nationals employed in EU Member States.

[22] House of Lords, 'Brexit: UK-EU movement of people' HL Paper 121, 3.

If the UK government continues to authorize EU citizens to work, other States may have to impose on British citizens' permissions as well. Other possible limitations have also come up with ideas that would allow employment in the case of specific qualifications or language skills.

5. How to Proceed Further? Opportunities and Directions

Since the 2016 referendum, there has been growing debate about the relationship between the United Kingdom and the EU. The central point of these debates is the free movement of persons and immigration. The result of the vote revealed that most of the voters were worried about EU migration to the country that is almost unregulated. On the basis of the above it can be said that, in addition to achieving separation, the maintenance of access to the single market at a certain level is justified.

5.1. Together, but still separated…

It seems to be an optimal tool in this delicate but crucial question to set up a model in which, besides migration control, free movement of persons can be maintained to some extent. It is possible to assume a direction for a solution that, in accordance with the Cameroon concept before the Brexit process, cooperation with European states is not excluded, but (as in Liechtenstein's situation) is based on the EEA agreement.[23]

Following the vote on Brexit, a large part of the debates highlighted the apparent incompatibility, contrasting with the policies that restrict migration and the UK's steady access to the single market. One of the central issues of the Brexit negotiations can thus be finding solutions and legal instruments that can make the limitation of migration so that the restrictive state can still – even if not fully – remain in the common market.

Future procedures and exit negotiations must inevitably be part of the examination of both the EU treaties and the so-called EEA emergency brake clause and their possible harmonization. The latter clause would allow the Contracting State to suspend the effective exercise of the

[23] 'Brexit: Free Movement of Persons' (*Shearman & Sterling LLP Client Publication*, 5 August 2016) <http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/08/Brexit-Free-Movement-of-Persons-FIAFR-080516.pdf>.

principle of free movement, in certain cases and during a given transitional period, in certain situations.

5.2. The EEA Agreement

It is important to note that in addition to its differences, the provisions of the Treaties fundamentally reflect the EEA Agreement. [24] This can be relevant for the United Kingdom, as it is not possible to restrict free employment accordingly, if the EEA agreement is formally amended by an addition.

The EEA, on the other hand, has the above mentioned emergency brake clause. Article 112 of the Agreement allows for a temporary suspension in the event of a serious economic, social and environmental threat, which may be a sector-based or regional situation. With this provision being enforced, the contracting party may unilaterally take security measures to limit his obligations under the EEA Agreement. In the course of implementation, the agreement is subject to several conditions. On the one hand, it is mandatory to continue the preliminary consultations and to give a one-month long notice period to the other contracting parties. An additional requirement during application is that after the introduction, the existence of the situation and the reasons for the suspension need to be reviewed in every three months. It is important to note that the scope and content of these measures must be proportional to the difficulties encountered and must not exceed the degree of difficulty. The crossing of the ratio places the rights of the other members of the EEA Agreement to restore the "rebound balance". The procedural requirements are thus rigorous and based on reciprocity. [25] The reason for this is that the relatively mild regulatory model in the degree of integration also aims at mutual cooperation.

One way that might eventually work, would be to develop a legal solution similar to the situation of Switzerland or Norway, in any case a model in which, apart from some limitation to migration, economic interruption does not occur. It is important, however, that quantitative limits and, as stated above, the possibility of suspending the cooperation will be unlikely to keep full access to the common market.

The EEA Convention or a bilateral agreement (similar to Switzerland), therefore, allows the UK to find a solution on the migration issue, but it is

[24] Agreement on the European Economic Area [1994] OJ L1/ 3.
[25] Bobowiec (n 18) 117.

also necessary to count on its irreversible results on the free movement principle.

From the analysis and possible models of solution are therefore highly probable that the British will continue to pursue European economic cooperation, similar to the EEA-model. The Norwegian model is considered to be the least disadvantageous for the British economy, yet it provides the fullest possible access to the common market. If the UK were to become part of the European Economic Area under the EEA Agreement then the policy of agriculture, fisheries, customs and trade would not be a part of cooperation. Another exception would be the common defence policy. In these regulatory areas, the United Kingdom would rely upon its own legislation. But this, of course, would also exclude the state from the benefits and possible subsidies.

6. Final Thoughts

Last year was a turning point not just for the United Kingdom, but for the whole European Union. The scholarship and the related analyses expressly interpret the situation as a crisis, which has been the biggest challenge ever since the EU was established in the months that followed.[26]

The most significant issue of the European future of the United Kingdom will be the evolution of the four fundamental freedoms. Whatever solution to choose and to coordinate with the British policy, if it is to pursue a certain degree of economic gain, it is compulsory to keep some of the four fundamental freedoms, including free movement of workers and free movement of persons. The future participation of Britain in the common market can only be imagined if, to the necessary extent, they also accept the principle of these four freedoms. [27] The phenomenon of Brexit can be a real test for both the success of channelling interest in the political negotiations and finding a proper balance of benefits and disadvantages.

To sum it up, the United Kingdom is certainly making history in terms of putting an end to its EU membership. The expected outcomes and most importantly, long-term effects can only be said from a long perspective, but one thing is certain: it is not only at the level of positive law that a

[26] István Magas 'Európai Unió: Útelágazás és Brexit-tanulságok' [European Union: Crossroads and Brexit-lessons] (2016) 11 (3) Köz-gazdaság 43.

[27] Bobowiec (n 18).

member state terminates its membership in the EU. Moreover, principled opportunity for an exit also seems feasible in practice. Nevertheless, it is important to keep in mind that Brexit carries a further message, too: if any state, such as the United Kingdom leaves the EU, it can serve as a precedent for other member states. This could have an effect not only on the idea of integration, but can loosen the whole substance of it as well. The economic benefits and co-existence provided security for the peoples of Europe.

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Application and Implementation of Directive 2008/48/EC in the Slovak Legal Order

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Abstract: This paper deals with the question on whether the Act No. 129/2010 Coll. on consumer credits has dully implemented the Directive 2008/48/EC, and if not, which are the particular provisions calling for correction, particularly in light of the judgement of the CJEU in the case C-42/15 Home Credit Slovakia a.s. v Klára Bíróová. Moreover, the paper zooms in on judgements of the Slovak national courts, the appeal courts especially, in order to find out whether interpretation and application of the Act is not at odds with the wording and purpose of the Directive. As a conclusion, the paper does not only analyse the legislation and their compliance with EU law, but it goes one step further as it seeks for information on application of the legislation in practice. Consequently, the paper discovers current problems with the real approximation of the laws on consumer credits.

Keywords: Consumer Credits, Act No. 129/2010 Coll., Directive 2008/48/EC, C-42/15

1. Introduction

In the area of the European Union, the consumer credits have been growing since 1950s. Due to the increasing over-indebtedness of consumers, partly caused by complexity of the consumer credit contracts and inability of the consumers to assess the real impact of the credit on them, legislation started to be adopted in order to prevent these issues. At the end of 1986, "*EU*" Directive 87/102/EC was adopted.[1] Later on,

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[1] Laurence Attuel-Mendès and Arvind Ashta, 'The truth, but not always the whole truth, in lending laws' (2013) 27 (2) Cost Management 6, 11.

this Directive was replaced by the new Directive 2008/48/EC.[2] On 9 March 2010, the new Directive was implemented into Slovak legal order by the Act No. 129/2010 Coll. *on consumer credits and on the other credits and loans for the consumers.*[3,4] Although the Act has been in force for more than seven years, certain issues regarding its compatibility with the Directive are more than actual.

This paper focuses on the question whether the Act has dully implemented the Directive, and if not, which are the particular provisions calling for correction. Consequently, the paper assesses both the compatibility of the Act's wording with the wording of the Directive as well as whether the "*spirit"* of the Directive is observed by the Act. Light is shed particularly on compulsory information which must be incorporated in a consumer credit agreement. Subsequently, this analysis is supplemented with judgements of the Slovak Regional Courts which are the appeal courts in the Slovak legal order and thus should be the final instance for the majority of the cases. On the top of that, the paper zooms in on the recent judgement of the CJEU, C-42/15 *Home Credit Slovakia v Klára Bíróová*[5], which enlightened certain parts of the Directive.

The paper is primarily based on the legal norms at stake, together with the chosen judgements of the Slovak Regional Courts and the CJEU. Secondarily, various Articles discussing the issues with consumer credits are presented as they supplement the legal analysis when possible. Electronic sources are used too, especially regarding the case C-42/15, as it has not been discussed in journals yet.

The paper is divided into two parts. The first part discusses the consumer credit laws from the perspective of the Directive, of the Act, and of the Slovak courts respectively. The second part is dedicated to the case C-42/15, and, particularly, it presents the facts of the case, the view of the AG Sharpston and the reasoning presented in the judgement *per se*. In conclusion, the paper collects the main findings presented in the paper

[2] Directive 2008/48/EC of the European Parliament and of the Council on credit agreements for consumers and repealing Council Directive 87/102/EEC [2008] OJ L133/66 (hereinafter "*the Directive*").

[3] Hereinafter "*the Act*".

[4] The translation of the Slovak name of the Act is slightly different in the Judgment of 9 November 2016, *Home Credit Slovakia a.s. v Klára Bíróová*, C-42/15, EU:C:2016:842. In the case, it is referred as "*Law No 129/2010 on consumer credit and other forms of credit and loans for consumers, amending certain other laws*".

[5] See n 4, hereinafter "*C-42/15*".

and it answers the question on whether the Directive was dully implemented into the Slovak legal order and whether the application and interpretation of the Act by the Slovak courts is in line with the Directive.

2. Consumer credit laws

2.1. The Directive

The Directive was adopted on 23 April 2008[6], since the first Directive 87/102/EC did not fulfil the aim to harmonise the national laws and the national laws remained different.[7] Yet, the development of the internal market is not the only goal of the current Directive.[8] The market should offer sufficient protection for consumers as well.[9] They are considered to be the most significant, yet the least knowledgeable[10] recipients of financial products and services.[11] The consumers should be able to make their decisions about a credit agreement in full knowledge of the facts.[12]

[6] The implementation period was until 12 May 2010. See Article 27 (1) of the Directive.

[7] Recitals 2-4 of the Directive.

[8] Internal market as the aim of the Directive is presented in the Directive, recitals 6, 7, 9, 10, 28, 34, 43. Moreover, this internal market should be "*genuine*". See C-42/15, AG Sharpston, point 2.

[9] Consumer protection as the aim of the Directive is presented in the Directive, recitals 8, 9, 18, 19, 24, 25, 26, 27, 31, 32, 36, 37, 38, 39, 41, 45.

[10] It is apt to note that to provide information is not enough. It is also important that consumers understand the information given. One of the ways to protect them is to improve their financial literacy. See Akos Rona-Tas and Alya Guseva, 'Information and consumer credit in Central and Eastern Europe' (2013) 41 (2) Journal of Comparative Economics 420, 429. On the financial literacy of the consumers in the UK, see Richard Disney and John Gathergood, 'Financial literacy and consumer credit portfolios' (2013) 37 (7) Journal of Banking & Finance 2246.

[11] Grażyna Szustak, 'Consumer Protection as a Premise to Build Trust in the Financial Service Market' (2014) 16 Journal of Economics & Management 114, 115. For an elaborated concept of trust, see also C. E. de Jager, 'A Question of Trust: the Pursuit of Consumer Trust in the Financial Sector by Means of EU Legislation' (2017) 40 (1) J Consum Policy 25, 27-33.

[12] The Directive, recitals 19, 24, 31, 32. After all, by protecting consumers, the default risk is reduced and creditors have greater chance to reach repayment of their money. See Attuel-Mendès and Ashta (n 1) 16.

The full harmonisation of certain aspects seemed necessary,[13] although it is a deviation from the original approach to the consumer law, which was built on the concept of minimum harmonisation.[14] Nevertheless, the optimum conditions are desirable for both lenders[15] and borrowers.[16] The protection of both sides of the market is important for proper functioning of the credit market.[17] Finally, the Directive shall respect the fundamental rights.[18]

The Directive harmonises several aspects of consumer credit agreements. The most important parts of the Directive are as follows. Chapter I defines the subject matter and the scope of the Directive.[19] Article 3 contains definitions of fifteen important terms which are, subsequently, used in the text of the Directive. Chapter II harmonises information and practices preliminary to the conclusion of the credit agreement[20] together with the obligation to assess the creditworthiness

[13] The Directive, recital 9. See also Article 1 and Article 22 (1) of the Directive. Nevertheless, as AG Sharpston explicitly pointed out that the full harmonisation was related only to certain aspects of Member States' rules concerning consumer credit agreements. See Opinion of Advocate General Sharpston, delivered on 9 June 2016, C-42/15, EU:C:2016:431, point 40.

[14] Hans-Wolfgang Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law? A Thought Provoking Impulse' (2013) 32 (1) Yearbook of European Law 266, 277. The move towards the full harmonisation escalated the debate between the defenders of the independence of national legal orders and the defenders of the unique European rules. See Hans-Wolfgang Micklitz, 'The Visible Hand of European Regulatory Private Law—The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation' (2009) 28 (1) Yearbook of European Law 3, 32.

[15] For the purposes of this paper, terms "*lender*" and "*creditor*" are understood as synonyms.

[16] The Directive, recital 8.

[17] Rona-Tas and Guseva (n 10) 433.

[18] The Directive, recital 45

[19] Regarding the scope of the Directive, see also Peter Rott, 'Renationalisation of direct selling—the impact of the new Consumer Rights Directive on financial services' (2012) 13 ERA Forum 35, 40.

[20] The data is given to the consumer in form of Standard European Consumer Credit Information in order to make them easily comparable for the consumer. See Mihaela-Irina Ionescu, 'Pre-contractual Information in Credit Agreements for Consumers' (2015) 9 Challenges of the Knowledge Society 250, 251.

of the consumer.[21] Chapter IV focuses on information and rights concerning credit agreement. Article 10 (1) prescribes credit agreements to be drawn up on paper or on another durable medium. Interestingly enough, the translation to the Slovak language changed the words "*on paper*" into the words "*in written form*" or "*in writing*". This does not seem to be of a great importance, however, an agreement "*in writing*" requires, under Slovak contract law, a signature for its validity, whereas "*on paper*" does not necessary requires so.[22]

Article 10 (2) of the Directive names information which shall be incorporated in the credit agreement in a clear and concise manner, i.e. compulsory information.[23] This Article should be implemented by the section 9 of the Slovak Act The discrepancies between the Directive and the Act implementing the Directive are discussed below.[24] At this point, it suffices to state that the provisions of Article 10 (2) a), b), d), e), g), i), j), k), l), m), o), q), s) were implemented more or less unquestionably.

Chapter VII focuses on the implementing measures. Article 23 is of particular importance, since it lays down the obligation for the Member States to introduce "*penalties applicable to infringements of the national provisions adopted pursuant to this Directive*". Therefore, the penalties appear to be within discretion of the Member States, save to the requirements of effectiveness, proportionality and dissuasiveness. Finally,

[21] It is worth noting that the Directive does not state criteria for evaluating of creditworthiness of consumer. It is therefore up to the Member States to regulate it or to leave room for private actors to do so. See Olha O. Cherednychenko, 'Cooperative or competitive? Privateregulators and public supervisors in the post-crisis European financial services landscape' (2016) 35 (1) Policy and Society 103, 106. For further elaboration on Articles 8 and 9 of the Directive, see F. Ferretti, 12-14.

[22] See part 3 of this paper.

[23] Information must be comprehensible. For further elaboration, see Rona-Tas and Guseva (n 10) 428.

[24] See part 2.2. of this paper.

2.2. The Act

The Directive was implemented into the Slovak legal order[25] via the Act No. 129/2010 Coll. The first part[26] of the Act is dedicated to the regulation of consumer credit. Sections 1 and 2 cover the scope of the Act as well as the definitions of the terms used therein. Sections 3 and following regulate the procedures and information provided before the conclusion of the consumer credit contracts.

2.2.1. Extra pieces of compulsory information

Information and rights related to the agreements on consumer credit are subject of the Section 9 of the Act. In addition to the Directive, the Act names five pieces of information which are compulsory for a consumer credit contract. In particular, the Section 9 prescribes that the agreement must contain address of the creditor where the consumer can exercise his right to complain[27]; personal identification of the consumer[28]; identification of the person whose proprietary right to goods or services is not transferred to the consumer by the moment of takeover of the goods or services[29]; retribution according to Section 53 (6) of the Act No 40/1964 Coll. Civil Code[30]; and name of the agreement which includes the words consumer credit in the suitable grammatical form[31].

Consequently, the Act is not a mere transposition of the Directive, not even as far as compulsory information is concerned. Moreover, these extra pieces of compulsory information, or rather their absences, are sanctioned by loss of profits for creditors.

25 In relation to certain aspects of implementation of the Directive in other Member States, see Mirela Niculae and Beatrice-Tanta Strat, 'Abusive Terms in Loan Contracts' (2015) 7 (1) Knowledge Horizons – Economics 131; Ionescu (n 20); G. Szustak (n 11); Cherednychenko (n 21); Micklitz, 'Do Consumers and Businesses Need a New Architecture of Consumer Law? A Thought Provoking Impulse' (n 14).

26 The other parts of the Act amend other Acts and Codes of the Slovak Legal Order.

27 The Act, section 9 (2) c).

28 The Act, section 9 (2) d).

29 The Act, section 9 (2) e).

30 The Act, section 9 (2) j).

31 The Act, section 9 (2) aa).

2.2.2. Marginal differences between the Articles of the Directive and the Sections of the Act

Thereto, certain provisions do not seem to fully correspond to the wording of the similar provisions in the Directive. The discrepancies vary as to their scale. For instance, the Article 10 (2) (f) lists the compulsory information related to the borrowing rate. The Slovak Act, Section 9 (2) i) omits the words "*where available*" in relation to certain information. However, the difference may not be crucial, as it is natural to state only that information which is available.

Similarly, there is a difference between the Article 10 (2) (r) and the Section 9 (2) u), both related to the right of early repayment. The former prescribes information concerning the creditor's right to compensation to be given only "*where applicable*", the latter does not contain the words, hence requiring the information to be given in all cases. None the less, the difference in practice seems only marginal. The same situation occurs in relation to the competent supervisory authority.[32]

Article 10 (2) (u) of the Directive prescribes for the consumer credit agreement to incorporate other contractual terms and conditions, where applicable. The Slovak Act does not contain such a provision, however, it is rather natural that if there are certain special contractual terms and conditions, they should be incorporated in the agreement.

Another instance where the wording of the Act differs from the one of the Directive is related to the notarial fees. The Article 10 (2) (n) requires: "*where applicable, a statement, that notarial fees will be payable*"; whereas the Section 9 (2) s) asks for: "*amount of the fees paid by consumer for acts of notary, if they are known to creditor*". On the one hand, the Slovak law requires the creditor to state the piece of information only when the creditor is aware of it; on the other hand, the creditor has to state the amount of fees, hence not the mere fact that there are some notarial fees payable, as it flows from the Directive. Nevertheless, this difference does not seem to cause issues in practice.

The Article 10 (2) (p) obliges the creditor to incorporate information about the right of withdrawal, including information concerning the obligation of the consumer to pay the capital drawn down and the interest and the amount of interest payable per day. The Slovak version seems more favourable for the creditors as to the last named piece of

[32] Compare The Directive, art 10 (2) (V) with the Act, section 9 (2) y).

information. The creditors must state the amount of interest payable per day or the way of its calculation.[33] In any case, the difference does not seem to be of great importance in practice.

Slight difference in wording occurs in relation to an out-of-court complaint and redress mechanism for the consumer. The Directive requires the methods for having access to it to be stated[34], and the Slovak Law requires information about such possibility only.[35]

2.2.3. Significant differences between the Articles of the Directive and the Sections of the Act

Apart from the instances mentioned above, certain differences might be of predominant importance, in theory as well as in practice. Article 10 (2) (d) prescribes that the agreement contains the duration of the credit agreement. However, the Slovak Act adds that there is also need for the final due date of consumer credit.[36] Therefore, according to the Slovak law, the information that the consumer credit is for 24 months seems insufficient.

Likewise, the Article 10 (2) (h) states among compulsory information the amount, number and frequency of payments to be made by the consumer. On the other hand, the Section 9 (2) l) of the Act uses different formulation, as it requires the amount, number and due days of the principal sum (capital), the interest and other charges to be stated in the consumer credit agreement. Slovak law requires more than EU law, as the formulation *24 monthly instalments of 100 €* would satisfy the Directive, however, it would seem insufficient in the light of the Act. This difference is even deepened by the interpretation of the Slovak courts, as suggested in part 2.3.

2.2.4. Sanctions

What is of particular importance is Section 11 which implements the Article 23 of the Directive on penalties. The only requirements for the penalties are that they must be effective, proportionate and dissuasive.

33 The Act, section 9 (2) x).
34 The Directive, art 10 (2) (t).
35 The Act, section 9 (2) w).
36 The Act, section 9 (2) f).

The Slovak legislator decided for penalty in the form of the consumer credit agreement becoming interest-free and free of any charges. Thus, if the provisions specified in the Section 11 of the Act are breached, the creditor will be punished, as he will not "*earn*" anything from the agreement.

The provisions of the Act which are sanctioned are, e.g.[37] absence of the written form; annual percentage rate of charge is wrongly stated in the agreement; annual percentage rate of charge exceeds the amount set by separate regulations; creditor do not state all the fulfilment which flows from the agreement to the consumer or are related to them; absence of the named compulsory information in the contract. In relation to the last mentioned, the compulsory information sanctioned by this way is the majority of the compulsory information prescribed by the Section 9 (2) of the Act, also the ones which are in addition to the requirements of the Directive. [38]

2.3. The Slovak Courts

As it can be seen from the previous parts of the paper, there are certain discrepancies between the Act and the Directive. None the less, courts may often[39] overcome them by the euro-conforming interpretation[40] of the problematic provisions. Using the indirect effect of the European law is optimal due to the fact that the disputes are usually between two private parties[41], hence the direct effect of Directives is not allowed.[42]

However, the Slovak courts seem to take another direction. A good example is the interpretation of the Section 9 (2) l) of the Act, namely determination of amount, number and due days of the principal sum

37 The Act, section 11 (1).

38 In particular, the sanctioned provisions are Section 9 (2) a) - l). s), z), aa).

39 Naturally, this is apart from the limits of the euro-conforming interpretation.

40 In line with the well-known cases such as Judgment of 10 April 1984, *Von Colson*, 14/83, EU:C:1984:153. For further information, see, for instance Damian Chalmers, Gareth Davies, Giorigo Monti, *European Union Law* (3rd edn, reprinted, CUP 2015) 316-325; Paul Craig and Gráinne de Búrca, *EU Law, Text, Cases and Materials* (5th edn, OUP, 2011) 200-207.

41 Save to the instances where the creditor may be seen as a part of the state (e.g. due to the fact the creditor is owned by the state) in line with the cases of the CJEU such as Order of 26 May 2005, *Rohrbach*, C-297/03, EU:C:2005:315.

42 See Judgment of 26 February 1986, *Marshall*, 152/84, EU:C:1986:84.

(capital), the interest and other charges to be stated in the consumer credit agreement. It was necessary for the consumer to be informed, at the moment of signature of the agreement, which part of his instalment covered the principal sum and which part covered the interest and other charges. According to this interpretation, the courts throughout the Slovak territory[43] ask, *de facto*, for amortisation table to be incorporated into the consumer credit agreement. This does not seem to be in line with the wording of the Directive, Article 10 (2) (h)[44].

In the judgement of the Regional Court Banská Bystrica 13Co/648/2015, the creditor *qua* appellant pointed out the formalistic interpretation of the court of first instance.[45] Even though the Regional Court stated why the incorrect annual percentage rate of charge is of crucial importance for consumers[46], and therefore it is appropriate to sanction it; the Court did not state why the absence of *de facto* amortisation table should be sanctioned too. Naturally, one missing crucial piece of information is enough for sanction, however, *pro futuro* it would be apt to suggest the absence of which pieces of information is not appropriate for sanctioning.

3. The view of the CJEU in the case C-42/15

In November 2016, the CJEU issued an important case for the purposes of the consumer credit agreements, the case C-42/15. The facts of the case were as follows: Ms Bíróová borrowed 700 €[47] from a lender, Home Credit Slovakia, based on a credit agreement drawn up on the basis of a standard form completed on the date on which the loan was granted. The form contained compulsory information. The general terms and conditions *document* (hereinafter "*GT&CD*") was incorporated into the agreement by a cross-reference. Ms Bíróová confirmed by her signature

[43] Regional Court of Banská Bystrica 16Co/170/2016, Regional Court Košice 3Co/716/2014, Regional Court Trnava 23Co/303/2015.

[44] The credit agreement shall specify in a clear and concise manner "*the amount, number and frequency of payments to be made by the consumer and, where appropriate, the order in which payments will be allocated to different outstanding balances charged at different borrowing rates for the purposes of reimbursement".*

[45] 13Co/648/2015, para 4.

[46] This was in line with C-42/15, see below.

[47] The total amount she needed to repay was 1087,56 € in monthly instalments of 32,50 €. See: C-42/15, AG Sharpston, point 18.

in the agreement that she was aware of the *GT&CT* and that she agreed to be bound upon it. However, the *GT&CD* itself was not signed, even though a part of the compulsory information was contained therein.[48] Under those general terms and conditions, the borrower could request the lender to make available, free of charge at any time the amortisation table. The table clearly showed the payments owing and the periods and conditions of re-payment, including a breakdown of each repayment showing capital amortisation, interest and, where applicable, any additional costs. Nevertheless, the *GT&CD* did not state the proportion, between the sum paid for the capital and the sum paid for the interest and charges, for each monthly instalment.[49]

Ms Bíróová stopped repaying the loan after two monthly instalments. This led Home Credit Slovakia to demand payment of the whole sum of the loan together with default interest and default penalties provided for in the credit agreement. Not having obtained the payment sought, Home Credit Slovakia brought an action before the competent Slovak Court, which was also the referring court in the judgement of the CJEU.[50]

The referring court asked the CJEU seven questions. As usual, the CJEU regrouped the questions into several blocks and answered them in such order. As regards the first and second questions, the referring court asked whether the Directive requires all the information to be incorporated into a single document. The court stated that nothing in the Directive indicated such interpretation. AG Sharpston elaborated on an opposite question too, namely whether the Directive permitted the compulsory information to be supplied on paper in the lender's general terms of business (GT&CD). She submitted that it was possible, subject to several conditions.[51] The judges of the Court of Justice supported this line of though only partially,[52] as they required clear and precise cross-reference

48 C-42/15, AG Sharpston, point 22.

49 C-42/15, paras 17-24.

50 C-42/15, paras 25-26.

51 C-42/15, AG Sharpston, points 51-52.

52 The conditions themselves are not in the judgement of the court. See Candida Leone, 'ECJ in Home Credit Slovakia (C-42/15): MS can impose written form for the conclusion of credit contracts' (*Recent developments in European Consumer Law*, 14 November 2016) <http://recent-ecl.blogspot.sk/2016/11/ecj-in-home-credit-slovakia-c-4215.html> accessed 23 May 2017.

to another document, however, no reference to the specific sections was required, as suggested by AG Sharpston.[53]

Furthermore, the referring court asked whether a credit agreement drawn up on paper[54] must be signed by the parties. The CJEU specified that the referring court asked whether the national law might have required such signature. Neither Directive itself, nor EU law in general precluded such a requirement.[55] The same is valid regarding the question on whether the requirement of signature might have been applicable to all the details of such agreement, the GT&CD in the presented case. The CJEU answered that nothing in EU law precludes such requirements under the national law.[56]

As to the third and fourth questions, the Slovak court asked whether it is necessary to indicate, in the credit agreement, each payment by reference to a specific date. This question was connected to the interpretation of the Article 10 (2) (h) of the Directive. In line with the opinion of AG Sharpston, point 55, the court stressed the objective of the provision which was awareness of the consumers. If the consumer can identify, without difficulty and with certainty, the dates on which each payment shall be made, the objective of the Directive is fulfilled.[57] Hence, even if the credit agreement does not state specific date but only a general reference enabling the consumer to identify the payment dates, the Directive is satisfied.

The fifth and sixth questions are related to the need to incorporate an amortisation table into the credit agreement. This part of the ruling is of crucial importance for the discrepancies between the Act and the Directive presented above in part 2.2.3. The referring court asked whether Article 10 (2) (h) and (i)[58] of the Directive required a fixed-term credit

53 C-42/15, paras 30, 34.

54 The elaboration on the expression of "*on paper*" is provided by the AG Sharpston in points 24-34.

55 C-42/15, paras 36-41.

56 C-42/15, paras 42-44.

57 C-42/15, paras 46-50.

58 Article 10 (2) (h) was cited above. Article 10 (2) (i) stands as follows: "*The credit agreement shall specify in a clear and concise manner where capital amortisation of a credit agreement with a fixed duration is involved, the right of the consumer to receive, on request and free of charge, at any time throughout the duration of the credit agreement, a statement of account in the form of an amortisation table".* Following that, the provision specifies what should be incorporated in the amortisation table.

agreement providing for amortisation of the capital in consecutive instalments to state, in the form of an amortisation table, the part of each instalment that would be allocated to repayment of the capital. If not, the referring court asked whether such a provision might have been introduced by national law. The CJEU clearly stated that the amortisation table did not have to be incorporated into the credit agreement.[59] AG Sharpston pointed out in the point 61, with reference to the Article 10 (2) (i), that "*the right of the consumer to receive, on request and free of charge, at any time throughout the duration of the credit agreement, a statement of account in the form of an amortisation table*" would be rendered otiose if the lenders were obliged to provide the table only when the credit agreement is signed. Moreover, the Member States may not adopt obligations for the parties to the agreement which are not provided for in Directive, if the Directive harmonised that particular area. As this is the case regarding information which must be included in credit agreement,[60] the Slovak national law may not introduce such obligation into its national legal system.[61]

The seventh question is connected to penalties which the Member States are obliged to incorporate into their legal orders, as stated in Article 23 of the Directive. Even though the penalties remain within the discretion of the Member States, they must be effective, proportionate and dissuasive.[62] The CJEU stated that the penalty which consisted in the credit granted to be deemed to be interest-free and free of charges was in line with EU law, if the lender was penalised for an important failure, e.g. failure to mention the annual percentage rate of charge in a consumer credit agreement.[63] Therefore, in the presented case the court ruled that the creditor's breach of a vitally important obligation may be penalised,

[59] C-42/15, para 54.

[60] The full harmonisation is not challenged by the provision of Article 10 (2) (u): "*The credit agreement shall specify in a clear and concise manner where applicable, other contractual terms and conditions*", since this is connected to the terms and conditions agreed between the parties in the course of their contractual relationship. See C-42/15, para 57.

[61] C-42/15, paras 55-56. Interestingly enough, the judges again did not follow the opinion of AG Sharpston in the para 63.

[62] AG Sharpston pointed out that the requirements of the sanction to be effective and dissuasive were satisfied in this case. See C-42/15, AG Sharpston, para 67.

[63] Order of the Court of 16 November 2010, *Pohotovosť*, C-76/10, EU:C:2010:685, para 76.

under national law, by the creditor's forfeiture of entitlement to interest and charges. The vitally important obligations are, for instance, to include annual percentage rate of charge, number and frequency of payments, statement that notarial fees will be payable and sureties and insurance required. The essence of these obligations is to enable the consumer to assess the extent of his liability. On the other hand, when this consumer's ability is not at stake, the penalty is disproportionate.[64] The court explicitly stated the example of the failure to include into the credit agreement the name and the address of the competent supervisory authority.[65]

Generally we may observe that the CJEU interpreted the Directive in line with the teleological interpretation, as it always looked on the purpose of the Directive. Basically, if the rights of consumers were respected, the aim of the Directive was fulfilled.[66] Moreover, regarding compulsory information, the harmonisation by the Directive is full and pieces of compulsory information cannot be added by the national legislation implementing the Directive.

4. Conclusion

As it was presented in the paper, the Slovak legislator did not opt for mere transposition of the Directive into the Slovak legal order. The implementation process was made in time, however, it is doubtful whether it was made appropriately too. Focusing on the provisions on compulsory information, the Act added "*extra*" pieces of information which are not presented in the Directive. It was confirmed by the CJEU that the harmonisation is in this part full and the Slovak legislator should have not gone beyond the provisions of the Directive. The same is valid for the instances where the Act does not meet the formulation of the Directive in a way that the former adds something to the wording of the latter. The most prominent example of this instance is the amortisation table which is *de facto* required in the consumer credit agreement by the Section 9 (2) l) of the Act. The Slovak courts have required the amount, number and due dates of principal sum, interest and other charges to be incorporated into the consumer credit agreement. Yet, this line of judgements may be turned-over after the judgement of the CJEU in the case C-42/15. There has already been a judgement of the Regional Court Banská Bystrica

64 C-42/15, paras 69-72.
65 This requirement is stated in the Article 10 (2) (v) of the Directive.
66 C-42/15, paras 35, 48, 71, 72.

13Co/648/2015 which took into account this Luxembourg's judgement. Nevertheless, even this judgement did not explicitly state that amortisation table was no longer required.

The Directive expressly stated that the interests of the consumers on the one hand, and of the creditors on the other should be in balance. The Slovak judgements rather suggest the focus on the former only. Besides, this gentle balance should be preserved also when it comes to the sanctioning of creditors. The CJEU ruled that the sanction was in line with Article 23 of the Directive only when certain rights of consumer were at stake. However, even if the Slovak Regional Courts looked into the threatening of the position of the consumer, they did it only generally and not in relation to the particular piece of information missing in the consumer credit agreement. It shall not be enough to state that the consumer is the weaker party and that the provisions of the Act serve for protection of the consumer. More detailed analysis shall take place, otherwise the application of the Act might end up in formalism. The legal regulation shall aim to create the environment for socially beneficial outcome.

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Romania's Alternative Dispute Resolution Centre for the Banking System: Turning a Good Theory into a Bad Practice?

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Abstract: The present paper analyzes critically the effectiveness of remedies provided by the Romanian Government's Ordinance No 38/2015 regarding alternative dispute resolution for consumer disputes, which transposes into Romanian national law Directive 2013/11/EU on alternative dispute resolution for consumer disputes, especially the procedure applying to consumer credit issues. After almost a decade of on-going judicial disputes between overindebted credit consumers and banks regarding especially unfair contract terms and, starting with 2015, hardship clauses connected to consumer credits granted in foreign currencies, the Alternative Dispute Resolution Centre for the banking system, established by Ordinance No 38/2015, has proven rather ineffective, its results being rather modest. Most Romanian consumers are still suing the lending banks rather than making use of alternative dispute resolution models; the ones provided by Ordinance No 38/2015 are either unknown or, in many cases, regarded with high mistrust. The paper tries to summarize and explain the causes of this negative evolution, stemming from a great extent in the unsatisfactory quality of the transposing national text and the national negative campaign against the Alternative Dispute Resolution Centre, its functioning rules and procedures. As such, the paper argues that in practice, the transposing measure for Directive 2013/11/EU and the subsequent design of the Alternative Dispute Resolution Centre for the banking system is a state-of-the-art example of how to turn the good will of the European legislator into an ineffective remedy, helping neither banks nor the Romanian consumers in helping neither banks nor Romanian consumers in ending disputes which have been going on for years.

Keywords: alternative dispute resolution models, consumer credits, overindebtedness

1. Introduction. The economic context

Due to the sustained economic growth registered in Romania during 2000 – 2008 and especially during 2005 and 2008, consumer credit experienced a sharp rise, Romanian consumers being able to make bank loans increasingly easy. At the time, the credit contract knew no overall

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restrictions, and the Romanian National Bank, in spite of numerous warnings with regard to the overindebtedness of Romanian consumers in foreign currency, undertook no effort to restrict the users´ access to such credits. At that time, the only regulation thought to protect the consumers was Law No. 193/2000 regarding unfair terms in contracts between professionals and consumers, the transposition into national law of Directive 93/13/CEE. However, as later evolutions have shown, a series of commercial banks ignored the regulatory act, inserting in their contracts various clauses the consumer was forced to accept. These clauses would oblige him to accept supplementary and unjustified costs, which later on, courts removed from contracts on the grounds of their unfair character, in accordance with Law No. 193/2000.[1]

In effect, Romania´s market economy was experiencing a model previously described in US law & economics doctrine. Acting rationally, in the sense of maximizing its utility, the consumer was not interested in the secondary clauses of the contract which he/she was about to sign, knowing that on the one hand he/she could not negotiate a change of clauses, and that he/she could not spend additional resources on effectively decoding the effects of the aforementioned clauses on the other hand.[2] As such, professionals did nothing else than use the contractual standardization, practiced on a large-scale in banking in order to optimize their offers. However, even if these proved beneficial for the price of the loan, which decreased, the effects on the secondary clauses were not beneficial, standardization having a negative effect (*race to the bottom*), in the sense of the involution of contractual models and the necessity of the consumers to pay an increasingly higher price which they could not decode at the moment of signing the contracts.

The economic and financial crisis which erupted in 2008 – 2009 has led to the deterioration of the financial state of Romanian credit consumers, the subsequent rise of court trials dealing with the attempt to remove unfair terms from the contracts and the diminution of the pressure of the banks on the consumers. Last but not least, the crisis has also led to the need for legal intervention. It came into effect in two stages:

[2] Lucian Bercea, 'Market for lemons. O aplicație la încheierea contractelor standard între profesioniști și consumatori' in Dan Andrei Popescu and Ionut-Florin Popa (eds), *Liber Amicorum Liviu Pop. Reforma dreptului privat român în contextul federalismului juridic European* (Editura Universul Juridic 2015) 68–75.

firstly, the Emergency Ordinance No. 50/2010 regarding loan contracts for consumers, and secondly, through both Ordinance No. 38/2015 regarding the alternative dispute resolution between consumers and professionals and through various legislative initiatives caused by the sudden rise of the Swiss Franc at the beginning of 2015.

The present paper is limited to the study of the provisions of Emergency Ordinance No 38/2015, analyzing the efficiency of procedures enumerated by this normative act, given the fact that the alternative settlement mechanism of Emergency Ordinance No 38/2015 (OG 38/2015) is not widely used.

2. About Alternative Dispute Resolution generally and the ADR Directive

Alternative Dispute Resolution systems outside the court (*Alternative Dispute Resolution*, ADR) represent the totality of procedures and extra-judiciary techniques through which consumers and economic operators can reach an amiable settlement with regard to the disagreements linked with the purchase of a product or service, the aim of these procedures being the solution of the customers´ problems without turning to a law court.

If certain basic rules are respected, alternative dispute regulation systems can bring advantages for both consumers and economic operators, especially due to its accessibility (insignificant costs, reduced formalities) and the short time needed compared with a court trial. As a rule, alternative disputes require the implication of a third neutral party, such as an s an arbitrator, a mediator or an ombudsman.

Alternative disputes regulations have an interdisciplinary aspect due to the identification and analysis of the real conflict which determined the dispute as such, the reason one uses such extra-judiciary mechanisms is the definitive settlement of the conflict, not a partial compromise, which would only mean a temporary palliative.

The applicability of ADR excludes general services of public interest without economic significance as well as medical services such as they are defined by article 3 letter (a) of the Directive 2011/24/EU. Likewise, ADR procedures are not applicable in the case of conflicts between economic agents or economic agents vs. consumers. In accordance with Recital 23 of the ADR Directive, it „*should not apply to procedures before consumer-complaint handling systems operated by the trader, nor to direct negotiations between the parties. Furthermore, it should not apply*

to attempts made by a judge to settle a dispute in the course of a judicial proceeding concerning that dispute." Concomitantly, Article 2 of the ADR Directive expressly excludes conflicts between entities of public higher or complementary education.

3. The Centre for Alternative Dispute Resolution in Banking (CSALB): organization, functioning, procedures

3.1 Organization, functioning and preliminary information

Government Ordinance No. 38/2015 (OG 38/2015) regarding the alternative dispute resolution between consumers and professionals created in Romania the legal framework for the alternative dispute regulations towards entities which apply alternative dispute regulations ("ADR entities").

In accordance with Article 2 (1) of OG 38/2015, the scope of this regulation is given by extra judiciary dispute resolution procedures applying to national and transnational disputes concerning sales and service contracts concluded between a professional acting in Romania and a consumer residing in the European Union, by the intervention of an entity for alternative dispute resolution, which proposes or imposes a solution and which is acting in Romania.

The present study is limited to the solution problematic of the alternative dispute regulations in which overindebted credit consumers are involved. The analysis will focus exclusively on the alternative dispute resolution procedures organized by the CSALB, founded in accordance with the provisions of Article 21 of OG 38/2015.

CSALB is an autonomous legal entity, non-governmental, apolitical, of public interest, and represents "*the only entity of alternative dispute resolution within the banking system*". The Centre organizes and administers ADR procedures through which it proposes or imposes a solution to the involved parties. CSALB has the mission to organize the settlement through ADR procedures of conflicts between consumers and economic agents whose activity is regulated, authorized and monitored by the National Bank of Romania (BNR), as well as branch offices of economic agents who conduct their business on Romanian territory.

The CSALB activity focuses on the administration of infrastructure necessary for the ADR and is coordinated by a Collegium, made up of five members, of which four are named by the National Authority for Consumer

Protection (ANPC), the National Bank of Romania, the Romanian Banks´ Association (ARB) and consumer associations, and one member is independent[3], having been chosen by the other four.

Only persons from the CSALB list of conciliators are dealing with the settlements– who need to have a financial expertise, meaning that they must have already been active for 10 years as lawyers or economists. They also must have a good reputation, be independent and impartial.

CSALB has two different sets of procedures: the procedure which is finalized through the proposition of a solution (reconciliation) and the procedure which is finalized through imposing a solution (arbitration). The access to both procedures is conditioned by the warranty of the following rules: (i) the consumer can prove that he "tried to contact the economic agent in question in order to discuss the reclamation", looking for a settlement with the economic agent. In other words, the preliminary procedure of reconciliation is mandatory; the omission to do so is a hindrance as far as access to the ADR is concerned; (ii) the conflict must have a value of above 1.000 lei (approximately 220 Euro); (iii) conflicts previously and definitively solved by a court cannot be subject to ADR; (iv) conflicts previously solved by Centrul SAL cannot be subject to ADR; (v) and *„conflicts promoted by the consumer 1 year after the conflict has arisen, or the date from which the conciliator presented the user´s complaint to the economic agent*".[4]

Concomitantly, Article 16 (1) of OG 38/2015 states that *„whenever alternative dispute resolution procedures are on-going, the prescription of the right to sue does not start and if it has started it shall be suspended"*. Article 16 (2) states that the provisions of (1) shall not interfere with prescription regulations established by international agreements to which Romania has adhered.

[3] The media and consumer associations have criticized the nomination procedure of the fifth member of the Collegium, considering that the activity of the Collegium is likely to be influenced by the banks, which are parties in the ADR procedures. We agree with those critics.

[4] According to Article 6 (4) (e) of the ADR Directive, "*Member States may, at their discretion, permit ADR entities to maintain and introduce procedural rules that allow them to refuse to deal with a given dispute on the grounds that: (…) (e) the consumer has not submitted the complaint to the ADR entity within a pre-specified time limit, which shall not be set at less than one year from the date upon which the consumer submitted the complaint to the trader; (…).*"

A few observations regarding the effect of ADR procedures on prescription terms should be considered:

Firstly, in Romanian law, prescriptions start on the date on which the beneficiary of the right to sue knows or should know that he has that right. It is difficult to imagine a hypothesis in which the prescription did not start before the initiation of ADR procedures, because nobody would make use of such a procedure if there would not be an interest deriving from a damaged right or a legitimate interest.

Secondly, with regard to the exemption of disputes initiated by the consumer after one year since their occurrence, we think that it should be clarified what one has to understand by "*the date of the occurrence."* E.g., if we consider a consumer credit contract, the consumer pretending that the contract contains unfair terms on certain fees, the illegal action is the perception of money due to the unfair terms. In that case, the date of occurrence is, in one explanation, the date when the reimbursement schedule was issued, including the sums asked for on the grounds of the unfair terms, situation in which the initiation of an ADR procedure is sometimes impossible, if more than one year has passed by. If we interpret the date of occurrence as being the latest date on which the consumer has been informed about a modification of the interest rate (calculated on the grounds of an unfair term), than the dispute may be settled by the ADR procedure. In any case, the regulation of the issue on stake is clearer in the Directive than in the national transposing regulation.

It should be noted that parties who have undergone ADR procedures whose result is not mandatory (ADR procedures finalized with the proposition of a solution, which has failed) are allowed to make use of a court procedure, through which they should make either the same requests to the Court as those put forward before the CSALB or a request for compensation of damages, without the professional being able to oppose to them the prescription term.

Entities which make use of ADR procedures are obliged to clearly inform the parties involved with regard to choosing any solving mechanism. As an example, Article 11 of OG 38/2015 states that, in the case of ADR procedures proposing a solution, the consumer must be informed before the start of the procedures regarding the possibility to withdraw at any moment, if he is not satisfied with the functioning or process of the procedure. Concomitantly, before accepting the proposed

solution, the parties must be informed with regard to the following aspects: (i) the possibility to accept or not the proposed solution; (ii) that the implication in the procedure does not exclude the possibility to sue for damages with a court; (iii) that the proposed solution can be different from a result given by a legal court which applies legal provisions; (iv) the judicial consequences of accepting such a solution.

Similarly, Article 12 of OG 38/2015 maps out the obligation to inform both parties before choosing the possibility of ADR procedures through imposing a solution with regard to the following aspects: (i) the obligatory character of the solution; (ii) that none of the parties may withdraw from the procedure; (iii) implication into the procedure does not exclude the possibility to sue for damages in a court procedure; (iv) the proposed solution can be different from the result given by a court which applies legal provisions; (iv) the legal consequences of such a solution.

3.2. The procedure finalized with the proposition of a solution

The ADR procedure finalized with the proposition of a solution (conciliation) is regulated by Article 11 of OG 38/2015 and detailed through the CSALB´s own secondary regulations.

Although the procedure is initiated by the plaintiff, the agreement of the economic agent is also needed. As a result, ADR procedures are, practically, only possible with the accord of the respondent, unlike the court system, which does not need such a premise.

The notification of the CSALB is done by the consumer, through a request for conciliation, which essentially must have the same elements like a request for summons, to which the proof of preliminary procedure as well as the agreement of the economic agent to participate in the ADR procedures will be attached.

The conciliator who will lead the ADR procedures can be chosen by the consumer, provided that he/she is also accepted by the economic agent. If the economic agent will refuse the confirmation of the chosen conciliator, or if the conciliator will abstain because of incompatibility aspects, an independent member of the CSALB Collegium will name another conciliator from its own list of conciliators.

After the examination of the complaint, the conciliator will issue a pronouncement on the admissibility of the ADR procedures in that specific conflict, no later than 3 days after the receipt of the complaint. If the

request is considered admissible, the secretariat of the ADR Centre will transmit the request to the economic agent, together with the written proofs. The latter will no later than 5 days after the receipt of said request transmit to the ADR Centre his opinion on the consumer´s requests. The Secretariat will transmit all these documents to the conciliator, who, if necessary, will set a date, no later than 10 days from the date of receipt.

After the study of the papers, and if needed, the hearing of both parties, the conciliator will suggest a solution for the conflict through a "*minutes of solution*", which he will transmit to both parties through the Secretariat. The conciliator will set a date no later than 15 days from the issue of the suggested solution on which the parties will be asked to debate the proposed solution and to take a decision. If the parties agree with the suggested solution, the conciliator pronounces a pronouncement in which he mentions the argumentation of the said pronouncement and the accord of each party. Should the consumer not revoke the suggested solution within a time span of 15 days, the pronouncement is to be seen as enforceable, in accordance with Article 7 (1) n) of the OG 38/2015.

Thus, we might have the impression that the enforceable title is the conciliator's pronouncement. With regard to that pronouncement, the law states that it shall contain, together with the explanation of the proposed solution, the parties' agreement. Which shall be the legal nature of the conciliator's pronouncement? If we admit that this pronouncement is an unilateral act originating in the will of the conciliator, how could there be inserted in that respective pronouncement the parties' agreements? This unclearness is increased by Article 15 (1) a) of the CSALB's procedure regulations which state that the conciliation procedure ends either by concluding a contract between the parties for the acceptance of the solution proposed by the conciliator. We could thus understand that the enforceable title is not the conciliator's pronouncement, but the parties' contract incorporating the solution proposed by the conciliator.

The conciliation procedure can end up also by the drafting of a minutes containing the failure of the conciliation or by the notification issued by any party that he/she withdraws from the procedure.

But what happens if the parties do not notify that they withdraw from the procedure, although they initially agreed with the solution proposed by the conciliator, only not to show up later on for the signing of the agreement? As long as we admit that the enforceable title is that agreement build up on the proposal of the conciliator, we conclude that

the refusal of any party to sign the agreement means nothing else but the failure of the procedure.

If the ADR procedures fail, the consumer who notified the CSALB is able to fall back upon a court or any other arbitration procedure, trying to secure his/her rights through a new endeavor.[5] Due to the confidential character of the procedure, Article 19 of the CSALB regulation stipulates certain interdictions of the parties who took part in the ADR procedures: these are obliged not to invoke in a judiciary or arbitration procedure: a) the points of view expressed during the conciliation procedure; b) the proposals of the conciliator, if they have not been accepted; c) the declarations of any party, by which he/she expressed the intention to accept the proposal of the conciliator.

3.3. The procedure finalized through imposing a solution

This procedure is regulated by Article 12 of OG 38/2015 and detailed through CSALB secondary regulations.

The ADR Centre organizes the settlement of conflicts through arbitration if the parties have reached a compromise through which the dispute resolution is given to one or more persons from the ADR Centre List. It will pronounce a final and compulsory judgment. The arbitration convention will be made in written form, under the sanction of nullity, and will have the form of the compromise which is concluded by the parties when the resolution of the consumer's reclamation fails. The compromise can be nevertheless concluded by atypical means, i.e. when consumer asks for the dispute resolution by the procedure finalized through imposing a solution to which the professional agrees in written form.

The procedure finalized through imposing a solution will take place during a time of maximum 90 days. The term will be suspended, in certain situations, if the following occurs: the trial of the challenge of the arbitrator; the replacement of the arbitrator or of the umpire; the trial of the unconstitutionality claim; the trial of an incidental claim filed to the

[5] According to Article 13 (3) of OG 38/2015, whenever the professional does not accept the proposed solution, the CSALB is obliged to inform the consumer about other administrative or judiciary means he or she can take against the professional in order to settle the dispute. We doubt that in this situation „a good understanding of legislation" is needed, as Article 6 (1) (a) provides in the case of the CSALB's personnel. Taking into consideration the complexity of applicable legislation, we think that a rather excellent understanding of legislation should be needed.

Bucharest Tribunal; the suspension of the trial on the grounds of a legal regulation; the accomplishment of an expert's report ordered by the arbitration tribunal.

Likewise, the 90 days time span can be prolonged with the accord of both parties to a period of three months, in the following cases: the death of the consumer, the declaration of the civil incapacity of the consumer; the cessation of the professional's legal personality.

The arbitration request will be submitted together with the proof concerning the attempt of direct settlement, the copy of all certificates the consumer wants to make use of and the copy of the compromise, which, according to the procedure regulations, represents the arbitration convention itself.

After formation, the tribunal will verify its competence in settling the conflict, pronouncing in this sense a conclusion, which will be considered null and void only by means of submitting a request for the annulment of the arbitrator's judgment, according to the Civil Procedure Code. Against the arbitration request filed by the consumer, the professional has the right to submit a defense, which shall contain, among other, the name of the arbitrator and his substitute, chosen by the professional, or otherwise the professional's accord with the choice made by the consumer.

The professional has the right to submit his own counter request if he has own claims against the consumer originating in the same contract.

The judgment pronounced in the procedure finalized through imposing a solution is final and compulsory, its effects being those of a final Court judgment. It is enforceable, according to the Civil Procedure Code. The judgment cannot be annulled otherwise than by the submission of a request for annulment, which has to be filed to the Bucharest Court of Appeal, only for the reasons stated by Article 608 of the Civil Procedure Code.

4. A critique of the CSALB procedures

Firstly, it should be shown that the exclusivity of the CSALB with regard to ADR procedures has been subject to some controversies. The objections were based on the fact that the CSALB exclusivity might be understood in such a way that the right of the consumer to choose the modality of conflict settlement would be limited to this procedures, to the detriment of the idea of free access to justice.

In accordance with the text of Article 21 (2) of OG 38 / 2015, *„conflicts in banking are settled exclusively through ADR procedures by the ADR Centre".* Both representatives of banking and those of consumer protection associations declared that the "exclusivity" means that –in the field of banking – there will be only one ADR Centre which will settle the conflicts and that this in no way diminishes the rights of the consumer to consider other variants, such as mediation, court, consumers´ associations or the National Authority for Consumers´ Protection (ANPC).

Besides, according to Recital 44 of the ADR Directive, *„in ADR procedures which aim at resolving the dispute by imposing a solution on the consumer, in a situation where there is no conflict of laws, the solution imposed should not result in the consumer being deprived of the protection afforded to him by the provisions that cannot be derogated from by agreement by virtue of the law of the Member State where the consumer and the trader are habitually resident*. (...)"

Thus, as far as the procedure finalized through imposing a solution is concerned, the consumer no longer enjoys the same liberty in his/her option to comply with the solution. The settlement of the conflict generates a mandatory solution for both parties involved, it having an enforceable character.

Secondly, the case of the conciliator's proposal in the procedure finalized by proposing a solution is unclear. We think that this aspect should have been clarified, *de lege lata*, because the efficiency of the whole procedure depends, in the end, on the possibility to enforce the conciliator's proposal. Even if that proposal has been accepted by the parties during the conciliation procedure, there must be guaranteed that each party has enough means to constrain the counter party to execute the obligation set up by the conciliatory proposal.

Thirdly, the interdiction to mention during a legal procedure in front of ordinary Courts the points of view expressed during the conciliatory procedure is for obvious reasons unreasonable. During a future Court procedure there will not be other arguments than those already expressed in front of the CSALB conciliator.

Last but not least, in case the parties opted for a ADR procedure through an imposed solution, the end will be an enforceable title. As a result, the Court cannot be notified except for an action whose object are certain damages. In this case, however, the Court will be held by the aspects stated by the CSALB through the arbitration procedure, the CSALB

judgment being thus granted *res judicata* power. This fact may lead to the situation in which ordinary Courts are held by the *res judicata* authority of CSALB decisions, whereas the CSALB is no court of justice. How legitimate are, in this case, fears generated by the mass-media[6] about CSALB offering a "parallel justice"?

We must expect that both the regulations of OG 38/2015 and the CSALB to be accused of being unconstitutional, since in accordance with Article 126 (1) of Romania´s Constitution, *„justice is enforced through the High Court of Cassation and Justice and the other courts appointed by the law"*, and not through the CSALB. It is true that the counterargument could be made that, as long as the same law maker allowed citizens to resort to private arbitration (regulated by Articles 541 and upcoming of the Civil Procedure Code), for the same reason the regulation of the CSALB should be considered fully in accord with the Constitution. Formally, this counterargument is based on the premises that ADR procedures organized in front of the CSALB are organized in accordance with the regulation of arbitration to be found in the Civil Procedure Code.

This conclusion is, however, not entirely accurate, as we will show *infra*.

In accordance with Article 601 (1) of the Civil Procedure Code, *„the court settles the conflict in accordance with the main contract and the applicable juridical norms, in accordance with Article 5."* In accordance with (2) of the same Article, it is stated: *„based on the agreement of both parties, the arbitration tribunal can solve the dispute by applying rules of equity."* As a result, in the arbitration procedure provided by the Civil Procedure Code the dispute must be solved according to applicable law and, as an exception and only when both parties ask for, on the grounds of equity, that being the only case when arbitrators are not obliged to take law into consideration but equity rules.

As far as both ADR procedures are concerned, the consumer is informed that *„the solution may differ from the result issued by a court applying valid regulations*", without specifying that such a situation should be only possible when the conflict is solved on equity grounds. *Per a contrario*, in the absence of such a limitation, drawing upon ADR procedures may expose the consumer to the risk of imposing a solution

6 <http://adevarul.ro/economie/stiri-economice/bancherii-si-au-facut-justitie-paralela-lupta-clientii-avocatii-acuza-existenta-prevederi-neconstitutionale-consumatorii-plang-opacitate 1_56faacad5ab6550cb85c10b9/index.html>

which is not based on valid law regulations, and concomitantly, nor on equity, which would seem difficult to accept.

As a result, the stake of ADR procedures´ efficiency cannot ignore this inexactitude. We consider that a serious reflection on the signification of the sentence "*the solution may differ from the result issued by a court applying valid regulations*" is necessary, given the fact that obeying valid regulations is the only guarantee the consumer has against arbitrariness. Under these circumstances, the existence of the rule of law creates for each participant to the civil circuit a horizon of legitimate expectancies, i.e. if his or her rights or interests are disregarded he or she is certain that he or she can address a Court which will hear his or her case and will pronounce a judgment by applying law in force.

Will the consumer give up its right to appeal to the common court system and opt for an ADR procedure finalized through imposing a solution which *"solution may differ from the result issued by a court applying valid regulations"*? Will the consumer easily renounce the guarantees (ensured not only by the internal, but also by European legislation) of a court system only to opt for an ADR procedure lacking any predictability?

There are also provisions which bring the hope that the arbitration tribunal organized by the CSALB will judge within the boundaries of the law. For example, Article 52 of the ADR procedures regulations state that the arbitration tribunal solves the case on the grounds of the contract and of applicable law, taking into consideration, whenever appropriate, commercial usances and general principles of law, or, on the request of the parties, on the grounds of equity.

Even such a provision can be interpreted differently. In accordance with the quoted text, the arbitration tribunal will settle the conflict firstly based on the agreement between the parties, and only then based on incident legal norms. What will happen when the contract clauses are in breach of imperative norms and common decency? Could the conciliator turned into an arbitrator fall back on the hierarchy established by Article 52, and would the principle of *pacta sunt servanda* be applied? The literal interpretation of Article 52 of the ADR regulation procedures would allow such a conclusion.

Thus, beyond the rhetoric of the question regarding the efficiency of ADR regulation procedures through the CSALB, a future legislative intervention will have to offer a convincing solution to the dilemma of how

can the imperative of cause settlement based on incident legal norms (in accordance with Article 52) be solved with imposing a solution which "*may differ from the result issued by a court applying valid regulations"*?

If we accept the premise that the conflict finalized by imposing a solution must be solved on the grounds of incident legal norms, then the solution should be no different from the solution which would be given by a common law court, which applies the same legal norms. The only situation in which the result can be different must be that in which the parties called for the settlement of the conflict on the grounds of equity, and this circumstantiation must be mentioned in the provisions of the OG 38/2015. Contrary to this, we are not of the opinion that we shall have a "judiciary" precedent within the ADR procedures of CSALB, finalized through imposing a solution.

5. Conclusions

Procedures regulated by the OG 38/2015 and the establishment of the CSALB have undoubtable started from a necessity, namely to offer to the consumer a more efficient means of conflict settlement which were generated by the abusive practices of certain banks in the last decade.

The transposition into national law of Directive 2013/11/UE by OG 38/2015 was partially flawed, the regulation adopted by the Romanian law-maker creating, at least occasionally, a confusion which could discourage the consumer to resort to alternative conflict resolutions through the CSALB. Similarly, the problems which were analyzed in section IV of the present paper indicate that the mechanism created by OG 38/2015 are far from a minimal efficiency standard which would make them attractive for consumers of bank-loans. Additionally, the founding of the CSALB coincided with negative comments in the mass-media, which has certainly contributed to the weakening of the consumers´ interest with regard to alternative regulation procedures which the law-maker has made available.

In order to analyze the efficiency of CSALB procedures, the problem of the possibility of imposing a solution which may differ from the result issued by a court applying valid regulations remains an essential one. Given the growing mistrust of consumers in banks, proven, among others, by the declining rate of financial intermediation, to the lowest level throughout the European Union (a drop from 39% in 2009 to 29% in

2016[7], not only that many consumers manifest their mistrust towards bank loans, but they also show a very low confidence towards the CSALB.

Thus, although the consumers´ interest towards the CSALB seems to be rising while it is continuing with its popularization campaign, the number of conflicts solved remains very small and insignificant in comparison with the number of legal actions between consumers and economic agents. According to the CSALB[8], in the first 10 months of activity (March-December 2016) there was a total of 46 cases, and between January-March 2017 a total of 19 cases. Despite the medial increase of cases per month from 4.6 in 2016 to 6.33 in the first trimester of this year, the number in question remains very small.

Also interesting is the fact that in spite of laying down the idea that CSALB would be an instrument created by credit institutions and under their influence, professions do not understand to resort to it, refusing the settlement through the Centre. In the report for the first trimester of 2017, Centre experts conclude that "*a certain reticence remains, for both consumers to use ADR procedures and economic agents to use the CSALB services.*"[9]

In other words, the alternative regulations of conflict in banking, although regulated in a more acceptable way, remains far from the conceptions and problems of consumers and professionals who still resort to the court system. This means that in spite of economic advantages which the ADR would presuppose, at least theoretically, neither professionals nor consumers see in the ADR a viable solution. More concretely, the high costs of money and time which the judiciary system presupposes are compensated, according to the involved parties, by the greater utility of a definitive court ruling, its enforceable character being undoubted.

It remains to be seen if this argument is not to be joined by others regarding the arbitrator's fair-mindedness, the certainty of procedural guarantees and the predictability of judgments. With regard to these aspects, in the case of the CSALB, bot the consumer and the professional have still to be convinced.

[7] Lucian Croitoru, 'Mirabila intermediere financiară' (*Lucian Croitoru*, 6 May 2017) <http://luciancroitoru.ro/2017/05/06/mirabila-intermediere-financiara/>.

[8] Centrul de soluționare alternativă a litigiilor în domeniul bancar, 'Raport trimestrial' 31.03.2017.

[9] ibid 4-5.

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New Challenges in the Field of European Insurance Law

Attila Vermes*

Abstract: There are more challenges according to European insurance law, in my publication I would like to analyse the followings. The first one is risk sharing, in regard to expanding Fintech and more specifically InsurTech firms and technologies, in this question we have to interpret, and in case of need recodify rules of founding and operating insurance firms. The second is cooperation between insurers, a question than arises as to in the world of IoT (Internet of Things), during spreading telemetric data, which data may be shared by insurers on an anonymized statistical base, or specified, for the reason of risk rating. The third field of my paper is mandatory motor liability insurance, where the insurance law status of drones require attention. The fourth part of my paper is the Directive 2016/97/EU of the European Parliament and of the Council of 20 January 2016 on insurance distribution.

Keywords: InsurTech, Big Data, cooperation between insurers, insurance of unmanned vehicles, insurance distribution

1. Risk sharing: Fintech / InsurTech

They key economical benefit that insurers expect from InsurTech is the challenge of meeting changing customer needs and the ability to match new offerings with their expectations. Clients now expect personalised insurance solutions, and average general contract terms simply don´t fit all. Being active in InsurTech could help incumbents discover emerging coverage needs and risks that require new insurance products and services to insure new practices: more and more individuals are taking advantage of game-changing solutions – they might be a host, a driver or simply a peer that wants to share risk with others, for example linking crowdsourcing with insurance is the P2P insurance business model which is based on the sharing economy concept. Crowdsource insurance

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provides access to cost-effective risk capital by bringing together a pool of policyholders. InsurTech is enabling traditional insurers to leverage existing data to generate deeper risk insights. Embracing InsurTech could help incumbent insurers gather more insightful and higher quality figures – a game changer, since insurance is a business relying on data risk insights. It would not only increase the speed of servicing and lower costs, but also open the way for ever greater product precision and customisation.

IoT is not only the industry´s buzz word but can prove to be very efficient in generating insights from external data sources. Some concrete examples are telematics and real-time weather observation that include sensors – analysis of the gathered data can identify unsafe driving, industrial equipment failure, impending health problems, and more. The sensor-driven approach is also being explored in life insurance by using lifestyle data as input.

Furthermore, behavioural analytics and advanced data analysis capabilities can help insurance companies gain a deeper understanding of behavioural trends, customary aspects and habits of individuals, allowing for the development and creation of customised solutions and better real-time and fast-track customer service. For example, in-car-sensors are already used to measure how safely policyholders drive and offer lower premiums to more careful road users. Traditional insurers fins InsurTech solutions valuable when developing new approaches to underwriting risk and predicting losses. Protection-based models are shifting to more sophisticated preventive models that facilitate loss mitigation in all insurance segments. The ability to capture and analyse data from different sensors and sources in near real time opens the door to more pro-active prevention models. From driving alerts to industrial equipment failure notices, this information will allow insurers to develop new approaches to more actively manage risk, most times in collaboration with the insured. We will see a shift from protection to prevention models, and even to deterministic models as has already happened in crop insurance.

2. Cooperation between insurers: data protection, antitrust law

According to the IBER Regulation[1] collaboration between insurance undertakings or within associations in the compilation of information (which may also involve some statistical calculations) allowing the calculation of the average cost of covering a specified risk in the pas or, for life insurance, tables of mortality rates or the frequency of illness, accident and invalidity, makes is possible to improve the knowledge of risks and facilitates the rating of risks for individuals companies, This can in turn facilitate market entry and thus benefit consumers. The shame applies to joint studies on the probable impact of extraneous circumstances that may influence the frequency or scale of claims, or the yield of different types of investments. It is, however, necessary to ensure that such collaboration is only exempted to the extent to which it is necessary to attaint these objectives. It is therefore appropriate to stipulate in particular that agreements on commercial premiums are no exempted. Indeed, commercial premiums may be lower that the amounts indicated by the compilations, tables or study results in question, since insurers can use the revenues from their investments in order to reduce their premiums. Moreover, the compilations, tables or studios in question should be non-binding and serve only for reference purposes.

Moreover, the narrower the categories into which statistics on the cost of covering a specified risk in the past are grouped, the more leeway insurance undertakings have to differentiate their commercial premiums when they calculate them. It is therefore appropriate to exempt joint compilations of the past cost of risks on condition that the available statistics are provided with as much detail and differentiation as is actuarially adequate.

Furthermore, access to the joint compilations, tables and study results is necessary both for insurance undertakings active on the geographic or product market in question and for those considering entering that market. Similarly access to such compilations, tables and study results may be a value to consumer organizations or customer organizations. Insurance undertakings not yet active on the market in question and consumer or customer organizations must be granted access to such compilations, tables and study results on reasonable, affordable and non-

[1] Commission Regulation (EU) No 267/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of agreements, decisions and concerted practices in the insurance sector [2010] OJ L83/1.

discriminatory terms, as compared with insurance undertakings already present on that market. Such terms might for examples include a commitment from an insurance undertaking not yet present on the market to provide statistical information on claims, should it ever enter the market and might also include membership of the association of insurers responsible for producing compilations. An exception to the requirement to grant access to consumer organizations and customer organizations should be possible on the grounds of public security, for example where the information relates to the security systems of nuclear plants or the weakness of flood prevention systems.

The reliability of joint compilations, tables and studios becomes greater as the amount of statistics on which they are based is increased. Insurers with high market shares may generate sufficient statistics internally to be able to make reliable compilations, but those with small market shares may not be able to do so, and new entrants are even less likely to be able to generate such statistics. The inclusion in such joint compilations, tables and studies of information from all insurers on a market, including large ones, in principle promotes competition by helping smaller insurers, and facilitates market entry. Given this specificity of the insurance sector, it is not appropriate to subject any exemption for such joint compilations, tables and studies to market share thresholds.

Co-insurance or co-reinsurance pools can, in certain limited circumstances, be necessary to allow the participating undertakings of a pool to provide insurance or reinsurance for risks for which they mighty only offer insufficient cover in the absence of the pool. Co-insurance or co-reinsurance pools can allow insurers and reinsurers to provide insurance or reinsurance for risks even if pooling goes beyond what is necessary to ensure that such a risk is covered. However, suck pools can involve restrictions of competition, such as the standardisation of policy conditions and even of amount of cover and premiums. It is therefore appropriate to lay down the circumstances in which such pools can benefit from exemption. For genuinely new risks it is not possible to know in advance what subscription capacity is necessary to cover the risk, nor whether two or more pools could co-exist for the purposes of providing the specific type of insurance concerned. A pooling arrangement offering the co-insurance of such new risks can therefore be exempted for a limited period of time without a market share threshold. Three years should

constitute an adequate period for the constitution of sufficient historical information on claims to assess the necessity or otherwise of a pool.

The executive officers of insurance companies, other members of the management body and their employees shall keep all insurance secrets confidential during and after their employment (term in office) The data and information obtained by such persons in their official capacity pertaining to the operation of the insurance company and to its clients can only be used when acting in such official capacity and in connection with and for the purpose of the insurance contracts to which they pertain. Said data and information obtained by the above-specified persons in their official capacity must not be used to obtain any direct or indirect advantage for themselves or for any other person and/or to be detriment of the insurance company or the policyholder.

Insurance secrets: Insurance secrets shall comprise all of the data – other than state secrets – in the possession of insurance companies, insurance intermediaries and insurance consultants that pertain to the particulars and financial situations (or business affairs) of their clients (including claimants) and the insurance contracts to which such clients are parties.

According to Act XLVII of 1997 on the Protection on Personal Data in the Field of Medicine, insurance companies shall be authorized to process any data pertaining to client´s health only for the reason seat in Act on Insurance Business and only in possession of the express written consent of the data subject.

Insurance companies, insurance intermediaries and insurance consultants shall be allowed to process the insurance secrets of clients only to the extent that they relate to the insurance contract, with its creation and registration, and to the service. Processing of such data shall take place only to the extent necessary for the conclusion, amendment and maintenance of the insurance contract and for the evaluation of claims arising from the contract. Unless otherwise provided by law, the owners, directors and employees of insurance companies, insurance intermediaries and insurance consultants and all other persons having access to insurance secrets in any way or form during their activities in insurance-related matters shall be required to maintain professional confidentiality with no time limit whatsoever.

Insurance companies shall be entitled to process personal data relating to any frustrated insurance contract as long as any claim can be

asserted in connection with the frustration of the contract. Insurance companies, insurance intermediaries and insurance consultants shall be required to delete all personal data relating to their current or former clients or to any frustrated contract in connection with which the data in question is no longer required, if the data subject has not given consent, or if it is lacking the legal grounds for processing data. In order to provide continuing effective protection of competition in the insurance sector while ensuring that the beneficial aspects of co-operations remain, the Commission considered several policy options. These were to (1) let the IBER expire as foresee in a sunset clause (baseline scenario). (2) to prolong the IBER for another ten years or (3) to prolong the IBER for either of the two exemptions. In its Report to the European Parliament and the Council on the functioning and future of IBER (COM(2016)54), the Commission already presented its preliminary view to let the IBER lapse because several of the considerations which let to the adoption and later prolongation of the INER are no longer present today.

After discussions with National Competition Authorities, the conclusion was, that for certain sensitive risks, e. g. terrorist attack and nuclear energy, the insurance sector needs to cooperate in order to provide cover.[2] The IBER Report already underlined that in certain instances, cooperation is necessary in insurance sector. A non-renewal of the IBER would not mean that such necessary cooperation would be prohibited in the future. Cooperation agreements would merely need to be assessed under standard competition rules, as is the case in other sectors. A non-renewal of the IBER would therefore not have a negative impact on pro-competitive cooperation.

The objective of the IBER review was to strike a balance between the need for effective perception of competition, prices and innovation on the one hand and on the other hand, the needs of the insurance industry to continua certain forms of co-operations that have a potential or restrict competition. Only one insurance association responding to the IBER public consultation provided also data on the potential costs of the IBER expiry. The association indicated that after the IBER expire, they would re-assess the compilations, tables and studies against the principles of the Horizontal Guidelines. This would lead to an on-off cost that is potentially

[2] European Commission, 'Summary of the stakeholder meeting on the IBER report 26 April 2016' 2 <http://ec.europa.eu/competition/sectors/financial_services/iber_event_summary_en.pdf>.

10-20% higher than the cost it incurred in the past under the IBER. The association underlined that this was a worst case estimate. Due to the very limited cos increase for the competition assessment, it is not expected that the cost for insurance premiums would increase after IBER expiry.

The Commission will monitor the impact of the lapsing of the IBER after March 2017. Particular during the initial 12-month period after the IBER expiry the Commission will observe and review whether the expiry leads to pronounced legal uncertainty. If that is the case, the Commission will explore the need for further guidance.[3] Insurers stressed that the implementation of the Solvency II Directive[4] (applicable from 2 January 2016) reinforces the need for more precise and accurate information on risks. The Solvency II regime sets out stricter risk capital requirements and obliges (re)insurers to calculate best estimate liabilities. The existence of information exchange on risks facilitated by the IBER would allow greater confidence in such best estimate calculations, and therefore help reduce the level of provisions that might otherwise need to be held in reserve, to the benefit of consumers.[5]

An inverted production cycle is typical for insurance, as premiums must be determined before the cost of insuring a risk are known. The premium is determined based on the probability of the occurrence of claims as calculated by the insurance company and is paid in advance by the contract signatories. As such, quotes in insurance are not the same as in other industries, because a simple calculation cannot be made to determine the cost price. Rather, a stochastic and actuarial analysis must be carried out baes on past cost. To assess the future cost of insuring risks today, insurers regularly collect their respective proprietary data on the occurrence of risks and their cost in the past. Such data are then aggregated by data providers or by associations of insurance companies.

[3] European Commission, 'Executive Summary of the Impact Assessment' SEC (2016) 536, 3.

[4] Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2009] OJ L335/1.

[5] European Commission, 'Report from the Commission to the European Parliament and the Council on the functioning of Commission Regulation (EC) No 267/2010 on the application of Article 101(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector' SWD(2016) 62 final, 18.

In Life insurance, aggregated date on services make is easier for all companies to assess their prudential situation. [6] In Hungary, the Government Decree 203/2011 (X.7.) on the exemption of certain groups of insurance contracts from the prohibition of restricting competition[7] is still in force.

3. Mandatory unmanned aircrafts liability insurance

According to the planned modification of the Government Decree 39/2001 of 5 March 2001 on the mandatory third-party liability insurance of air traffic[8] minimum insured sum of unmanned aircrafts will be

a) below 2 kg of maximum take-off weight 3 000 000 HUF,

b) between 2 kg - 10 kg of maximum take-off weight 5 000 000 HUF,

c) above 10 kg 10 000 000 Ft HUF.

The minimum insured sums were written after asking civil partners, professionals and state authorities.

According the planned decree on unmanned aircrafts of the Minister of National Development Art. 24. (1) b) has to prove the legality of the trip with valid third-party liability insurance policy or slip. Tot the registration of unmanned aircrafts is also required the above-mentioned insurance policy (Art. 31. (3) d).

According to the ministerial commentary to the planned ministerial decree, the registered keeper of should make the mandatory third-party liability insurance contract, but the actual operator should carry this original document by himself, to prove the legality of the usage in case of official investigation. The operator of a motor vehicle shall conclude a liability contract with an insurer to cover any damage that may be caused in the course of the operation of the motor vehicle up to the above-specified limit and shall keep such insurance contract in effect by regular premium payments. A motor vehicle may be operated in the territory of Hungary only if these criteria are met. The conclusion of the insurance contract is certified by the insurance policy or the certification sheet made

[6] European Commission (n 3) 7.

[7] National Bank of Hungary, 'Informative Guide to Laws and other Legal Provisions Regulating the Provision of Services in Hungary 2016', 14 <https://www.mnb.hu/letoltes/informative-guide-to-laws-and-other-legal-provisions-regulating-the-provision-of-services-in-hungary.pdf>.

[8] Planned decree on the issue of modification of Government decrees in the field of air traffic <http://www.kormany.hu/download/8/db/e0000/RPAS__honlapra.pdf>.

out by the insurer. The maintenance of the insurance contract by regular premium payment is proven by the receipt slip of the cash transfer order in proof of payment (cheque) or the certificate mad out by the insurer, with respect to the given period of premium payment.

The operator of a motor vehicle under vehicle licensing obligation shall produce the certificate of the existence of the insurance contract and the fact that it is kept permanently in effect through premium payment, in the cases specified by law. The compulsory motor vehicle liability insurance covers the settlement of well-founded compensation claims and the rejection of unfounded compensation claims imposed on insureds due to an accident caused by the operation of a motor vehicle specified in the insurance contract. The justification of a claim for compensation shall be established by the insurer by comparing the statement made by the insured concerning its responsibility and the available facts and data, according the liability of the insured. The insurer shall not compensate for damages occurred during motor race or the required training. The insurer may claim refunding of the amount it has paid in compensation from the insured or in the case of several motor vehicles form an one of them or each of them on a joint or several basis if the accident has been caused by violating the law or deliberately.

The insurer may claim refunding also from the insured or in the case of several motor vehicles from any one of them or each of them on a joint or several basis if the motor vehicle was driven under the influence of alcohol or other substances with negative impact on driving capability or if the driving of the motor vehicle was handed over to such person except if they could have not recognised the status of such person as under the influence of alcohol or other substances of similar impact.

If from the motor vehicle operator if the accident has been caused by gravely neglected technical condition of the motor vehicle, it is also a legal reason for refunding. In case of insurance event, the insured party has to fill an insurance report form for the insurance company, specifying the event and circumstances, weather conditions, mechanical failure or malfunction, the kind of flying and purpose, injuries or damage to other property. Using experimental devices or unstable batteries can be extra hazardous, in the first case the insurance premium will be higher, in the second case the activity will be uninsurable. Of course manufacturers of unmanned aircrafts are subject to the law of product liability, so the

manufacturer or the distributor is liable for the damage caused by their defective product.

The unmanned aircraft should be operated only be operators meeting the requirement of state law and the insurance contract. In case of personal injury the insurer shall pay on behalf of the insured all sums which the insured shall legally obligated to pay as damages. In case of property damage the insurer shall play all sums which the insured shall legally obligated to pay as damages.

The policy does not apply if the unmanned aircraft is a certified model and the Airworthiness Certificate of the unmanned aircraft is not in full force and effect. When insured event occurs, the insured shall take all reasonable precautions to protect the property or unmanned aircraft after an occurrence. The insurer shall reimburse the insured all reasonable cost in affording such protection. After the insured event, the insured shall not abandon the property or unmanned aircraft, allow the insurer or the insurer´s loss adjuster to inspect the property, and allow the insurer or the insurer´s loss adjuster to inspect all aircraft records, pilot logbooks, repair and service invoices, sales receipts and any other pertinent records until settlement of the loss.

4. Insurance distribution

The former Insurance Mediation Directive (IMD)[9] will be replaced by the new Insurance Distribution Directive (IDD)[10] . According to the new rules, Insurance supervisors should ensure effective monitoring of the activities of all new market participants, so that they comply with regulatory obligations.

Insurance legislation, rules or guidelines should be digital-friendly, technologically neutral and sufficiently future-proof to be fit for the digital age and encourage digital innovation. Regulators and supervisors should be encouraged to take initiatives to set up tools to supper marker player´s innovation that benefits customers. An extremely important European regulation is the IDD Directive on the Sale of Insurance, which was announced in February 2016. The new legal regulation brings a lot of

[9] Directive 2002/92/EC of the European Parliament and of the Council on insurance mediation [2002] OJ L9/3.

[10] Directive (EU) 2016/97 of the European Parliament and of the Council on insurance distribution (recast)Text with EEA relevance [2016] OJ L26/19.

changes primarily in life insurance because it regulates the sale of unit-linked life insurance policies in a way, similar to the MiFID Regulation. That is why, life insurers have been monitoring the developments from the very beginning and in 2017, when the second level rules become available, the market can duly prepare for the application of the directive from February 2018.

Short biography

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An Autocracy in the Single European Market – A Rationality Paradox?

Tamas Dezso Ziegler*

Abstract: The aim of this article is to highlight the discrepancy between the logic of the single European market and the market-related policies the Hungarian government, which created a system of oligarchs in the country. It wants to answer the question whether or not the new nationalist economic approach of the Hungarian government is economically and politically "rational" or not. It proves that many of these actions are irrational, either from an economic point of view, or because of their negative effects on law and the whole society.

Keywords: Hungary, EU membership, internal market, autocracy

1. Introduction

This article will attempt to answer the question of whether or not the new nationalist economic approach of the Hungarian government is economically and politically "rational" and if it conforms to EU law and local constitutional principles. Under nationalist economics I accept Pryke's definition[1] that economic nationalism should be understood as a set of practices to create, bolster and protect national (in the case of present article: Hungarian) economies in the context of world (and EU) markets. All measures could be mentioned here which try to support domestic economy, whether legally or against EU law, whether in a classical protectionist way (i.e. by excluding foreign goods), or by other methods (like by discriminating foreign companies, making conditions worse for them, etc.). We could find many supportive as well as several counter-arguments regarding these policies. Even outside Hungary we can see people sympathizing with nationalist politics, because they feel nationalist politicians can stop the rule of banks, multinational companies

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[1] Sam Pryke, 'Economic Nationalism: Theory, History and Prospects' (2012) 3 (3) Global Policy 281.

and the influx of "foreign" capital in their countries. After a period of privatisation, which was unable to create competitive markets compared to Western Europe in Eastern Europe, this view is shared by many in Hungary. I personally believe that international cooperation, including participation in free market areas is mostly beneficial for the participant countries, but it may also contain some dangers, like a backlash against trade, or social disintegration.[2] A kind of democratic dilemma also emerges: the more interconnected countries are, the less effect people will have on decision making, which becomes less democratic.[3] However, what is going on in Hungary has only limited connection to valid criticism of the "neoliberal world order", and if we analyse the actions more deeply, we notice that the same or similar economic elites stand behind many of the actions. This is in line with Pagano's opinion that state aid for domestic investments could be beneficial for a group seeking particular privileges at the expense of other (primarily social or economic) groups of the same nation.[4]

Antonio calls this new political phenomenon a new global tribalism: a movement which is anti-globalist, patriotic, fiercely nationalistic and supports protectionism, and he compares its European representatives to certain members of US paelo-conservatives.[5] This new movement follows certain intellectual patterns already known from history, like the theory of Liszt on protectionism in the early years of the 20th century or the theorists who demanded protection of citizens from businesses after the *laissez-faire* principle failed to do so. Some scholars like Berlin have claimed that there were two kinds of economic nationalism: "*the first is not aggressive and stresses co-operation, solidarity and familiarity with fellow countrymen while the other is aggressive and stresses conflict, violence and hate for foreigners*".[6] It is an interesting question which

[2] Dani Rodrik, *Has Globalization Gone Too Far?* (Institute for International Economics 1997) 69 ff.

[3] Dani Rodrik, *The Globalisation Paradox, Democracy and the Future of World Economy* (W. W. Norton 2011) 120 ff.

[4] Pagano cites Breton in Ugo Pagano, 'Can Economics Explain Nationalism?' (1992) 10 <http://ssrn.com/abstract=934273>.

[5] Robert J. Antonio, 'After Postmodernism: Reactionary Tribalism' (2000) 106 (1). American Journal of Sociology 40.

[6] Pagano cites Berlin in Ugo Pagano, (n 4). For the same argument Pelle Ahlerup and Gustav Hansson cite Brown, see 'Nationalism and Government Effectiveness' (2008)

serves public interest (and as such, rationality) better. For developing countries, in theory, economic nationalism could be a useful tool for furthering their own industries[7] – this is in line with Palma and Hirschman who claim that the economic centre of the world has different needs from the periphery.[8] However, Eastern-European countries strongly depend on EU money regarding regional developments. Moreover, Føllesdal and Hix cite Frieden and Rogowsky[9] to claim that 'private producers for domestic markets are losers from the liberalisation of trade in a single market'.[10] Føllesdal and Hix also mention claims of Pierson and Leibfried[11] and Joerges[12] that there clearly are winners and losers in the European cooperation among member states: why would it be any different in the field of commerce? This means that not all policies function in a Pareto efficient way: there are losers and winners of the single European market as well. One could also argue that public opinion about foreign businesses must be in line with the government actions, even though 'democratic contestation of these issues is not a perfect procedure'.[13] On the other hand, economic nationalism in Europe may cause numerous problems. Workman argues that economic protectionism may lead to higher consumer costs.[14] We saw a very similar effect in Hungary in connection with the watermelon cartel organized by the government, which pushed

University of Gothenburg Working Papers In Economics No 313 <https://gupea.ub.gu.se/bitstream/2077/17763/1/gupea_2077_17763_1.pdf>.

[7] Pagano cites List as the father of protectionist ides, see Pagano (n 4) 10.

[8] Pagano cites Palma and Hirschman as examples.

[9] Jeffry Frieden and Ronald Rogowski, 'The Impact of the International Economy on National Policies: An Analytical Overview' in Robert O. Keohane and Helen V. Milner (eds), *Internationalization and Domestic Politics* (CUP 1996).

[10] Andreas Føllesdal and Simon Hix, 'Why there is a Democratic Deficit in the EU: a Response to Majone and Moravcsik' (2000) 44 (3) JCMS 543.

[11] Paul Pierson and Stephan Leibfried, 'The Dynamics of Social Policy Integration' in Stephan Leibfried and Paul Pierson (eds) *European Social Policy: Between Fragmentation and Integration* (Brookings 1995).

[12] Christian Joerges, 'Der Philosoph als wahrer Rechtslehrer: Review of G. Majone, Regulating Europe' (1999) 5 (2) European Law Journal 147.

[13] Føllesdal and Hix (n 10) 555.

[14] Garrett Workman, 'Economic Nationalism: Transatlantic Responses To The Financial Crisis In Comparative Perspective' (MA thesis, University of North Carolina 2009) 32.

the price of watermelons higher, yet the government allowed it for assorted reasons.[15]

2. The Nature of the "Illiberal" Market in Hungary

Stemming from the nationalistic agenda, some of Hungary's new legislation has adversely affected the internal market, especially the free movement of goods, services and capital. At the level of rhetoric, the legislators' central assumption was that Hungarian companies serve the national interest better than foreign ones, Hungarian products are similarly better, and that buying domestic over imported is better for the Hungarian economy. Interestingly, nationalistic rhetoric also regards as a "foreign product" anything produced in Hungary by local affiliates of foreign companies. As a result, several European companies have been pushed out of the market by the government: the two areas which are in the centre of disputes are the supermarket and the banking sector.[16] The notion of economic protectionism in politics is not new in the country. Governments of recent times have regularly attempted to popularize the sale of Hungarian goods and to shore up the interests of domestic companies, a respectable intention when kept within certain limits. One motive for this was the lack of Hungarian industry to produce various types of valuable goods that could be distributed throughout Europe or even worldwide: national identity in this regard has always trumped reason. Another cause has been the lack of thinking internationally: while the European market of 500 million people certainly is a great historical achievement, utilising it is yet to be learnt. The education system is also not built for helping co-operation with foreign countries: the ratio of

[15] Nicholas Hirst, 'Hungary accused of tampering with EU antitrust investigation Investigation into price-fixing was stopped in April 2013' (*Politico*, 23 April 2014) <www.politico.eu/article/hungary-accused-of-tampering-with-eu-antitrust-investigation/>.

[16] For deeper analysis see Tamas Dezso Ziegler, 'The Links Between Human Rights and the Single European Market – Discrimination and Systemic Infringement' (2016) 7 (1) Comparative Law Review 1; HAS CSS Lendület-HPOPs Research Group, 'The Legal and Regulatory Environment for Economic Activity in Hungary: Market Access and Level Playing-field in the Single Market' (*HAS CSS Lendület-HPOPs Research Group*, Spirng 2016) <http://hpops.tk.mta.hu/uploads/files/ExpertReviewReport.pdf>; Marton Varju and Mónika Papp, 'The Crisis, National Economic Particularism and EU Law: What Can We Learn From the Hungarian Case?' (2016) 53 (6) CMLR 1647.

speakers of foreign languages in Hungary is one of the lowest in Europe, with only 35% of the population speaking at least one foreign language.[17] Therefore, the government's goal has been to increase domestic consumption of Hungarian goods, especially foodstuff and agricultural produce, which are a major part of the country's output. The fallacy of favouring a market of 10 million instead of one of 500 million has never been highlighted, and this phenomenon has been boosted by the re-discovered Hungarian nationalism.

In contrast, the Treaty on the Functioning of the European Union (TFEU)[18] creates a framework for four freedoms: goods, services, capital and persons may move freely in the European Union (or, to be more precise, in the European Economic Area). In conformity with this, the Union shall comprise a customs union that shall cover all trade in goods.[19] Moreover, all discriminating taxes or quantitative restrictions on imports or exports and measures having equivalent effect shall be prohibited among member states.[20] In practice, this means that there is no room for discrimination between goods in the EU, irrespective of their origin. The same is true regarding handling of companies: no discrimination is allowed between a company owned by foreign persons or companies and a domestically owned one. The basics of these rules can be found in Article 49 TFEU, which states that "*… restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited*" and also that "*…freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings… under the conditions laid down for its own nationals by the law of the country where such establishment is effected*". Article 54 TFEU also states that "*companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall… be treated in the same way as natural persons who are nationals of Member States*."

[17] European Commission, 'Special Eurobarometer 386: Europeans And Their Languages: Report' (2012), 15 <http://ec.europa.eu/public_opinion/archives/ebs/ebs_386_en.pdf>.

[18] Consolidated Version of the Treaty on the Functioning of the European Union [2016] OJ C202/47.

[19] See Art. 28 TFEU.

[20] See Arts. 34-35 TFEU.

Consequently, based on the logic of EU law, no member state (MS) may demand (directly or indirectly) that a foreign company registered in the EU– for example – pay more tax than domestic companies. Moreover, there are also unified rules for competition law as well as for state aid: according to these, a state has very limited latitude to aid local companies and even non-financial, unrealised funding is prohibited.[21] These provisions have been in place for decades, in certain areas even longer: e.g. the free movement of goods between member states was established at the end of the sixties. In sum, the EU generally disallows discrimination against foreign companies or against Hungarian subsidiaries, branches or agencies of foreign companies.[22] Furthermore, any discrimination based on nationality is prohibited.[23] Yet, these principles of deliberation and a liberal market are clearly confronting with the new policies in Hungary, where the dynamics of commercial law have changed fundamentally over the past few years. Some of the new rules may violate the notion of the free market while conforming to the letter of EU law. Others are clearly contrary to some provisions of competition law in the EU. A great many examples could get cited to prove these points, and I only cite some of them, which show the mechanics of market policies in Hungary.

Firstly, one could analyse the "alliance" between CBA, the largest Hungarian supermarket chain and the government. According to press news, CBA has even instructed its employees to support the government by attending pro-government rallies, openly advocated for PM Orbán, and in turn received incentives in the form of a beneficial tax system (including a new food chain control fee, the so-called "supermarket supervision fee", which seriously harmed foreign businesses, but less local supermarket chains, and which also triggered EU infringement procedures).[24] [25] The government has also banned the activity of any supermarket chain which

[21] Judgment of 20 September 2012, *French Republic v European Commission*, T-154/10, ECLI:EU:T:2012:452.

[22] See Art 49 TFEU.

[23] See Art 12 and 61 thereof.

[24] Judgment of 5 February 2014 (request for a preliminary ruling from Székesfehérvári Törvényszék — Hungary), *Hervis Sport- és Divatkereskedelmi Kft v Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Főigazgatósága*, C-385/12, EU:C:2014:47.

[25] European Commission, 'State aid: Commission opens two in-depth investigations into Hungary's food chain inspection fee and tax on tobacco sales' IP/15/5375.

does not post a profit over two consecutive years. This effected Tesco and Spar (both foreign companies) among others. There has been a blanket ban on new supermarkets since December 2011: in fact, no commercial facilities above 300 square meters were allowed to be built. This was the so-called mall-stop law, which also has resulted in an infringement procedure.[26] Finally, Sunday trading has been banned for large supermarkets for a while: it also served the interests of smaller domestic supermarket chains.

Very similar relations occurred regarding agricultural land leased by farmers. Many of these areas got reassigned to new tenants. Several reports by former Fidesz MP József Ángyán, a minister in the Fidesz government between 2010 and 2012, showed that in many counties just a handful of interest groups received most of the land, and allocation of plots was based on dubious criteria. Hungary lifted the ban on the purchase of land by foreigners in 2014. However, the new law still did not conform to EU rules, leading to yet another infringement procedure.[27]

The rise of the construction industry is also an interesting field in this regard, as several businessmen loyal to the government could have received a disproportionate volume of state contracts.[28] Interestingly, EU development funds may support local economic elites to become even wealthier. The media environment (government regulation and authorities) have also been dangerously centralized.[29] The voices of independent opinions have been very low, even during elections on television.[30] The government introduced additional new state TV channels

[26] 'Commission opens new infringement procedure against Hungary' (*Free Hungary*, 24 April 2014) <http://freehungary.hu/index.php/56-hirek/2832-commission-opens-new-infringement-procedure-against-hungary>.

[27] European Commission, 'Free movement of capital: Commission opens infringement procedure against Hungary on rights of cross-border investors to use agricultural land' IP/14/1152.

[28] 'EU may withhold funding to Hungary over road construction bidding rules' (*Politics.hu*, 23 January 2014) <http://www.politics.hu/20140123/eu-may-withhold-funding-to-hungary-over-road-construction-bidding-rules/>.

[29] Amy Brouillette and others, 'Hungarian Media Laws in Europe' (*Center for Media and Communication Studies*, 2012) <http://cmds.ceu.hu/sites/cmcs.ceu.hu/files/attachment/article/274/hungarianmedialawsineurope0.pdf>.

[30] OSCE, 'Hungary, Parliamentary Elections, 6 April 2014: Final Report' (11 July 2014) <http://www.osce.org/odihr/elections/hungary/121098>.

and also introduced a special tax payable above a certain threshold of revenue. By far the greatest loser of this tax was RTL. The new progressive tax was supposed to take 20 billion forints (65 million Euros), or 40 percent of their revenue, but did not affect smaller competitors. Eventually, when RTL began broadcasting news programmes that heavily criticized the government and the European Commission started a procedure in the case,[31] the tax was scaled back. Also, RTL's largest rival (TV2) has been bought up by businessmen loyal to the government.

Special taxes have been introduced to take "bumper profits" back from companies in the telecommunications and banking sectors (the banking sector alone was expected to pay 144 billion forints of tax in 2015). On the other hand, the government also wants foreign banks to leave the country: the head of the Central Bank (loyal to the government) said he believed that four major banks would leave the country in one to 15 years. The government has even made an offer to buy Raiffeisen's Hungarian operations, then in 2014 bought a major domestic bank from its foreign owners (Hungarian Foreign Trade Bank – MKB) as well as another (Budapest Bank). In early 2015, the government bought 15% of ERSTE Bank Hungary (other 15% was bought by the European Bank for Reconstruction and Development). Later, according to press news, some of them were sold to businessman close to the government.[32]

At the lower level of society, actions also show a kind of protectionist-oligarchic approach. The Hungarian government has introduced a law[33] on the optional labelling of Hungarian products,[34] with three categories: "Hungarian Product" ("*magyar termék*"; at least 90% Hungarian content), "Domestic Product" ("*hazai termék*"; at least 50% Hungarian content) and Processed in Hungary ("*hazai feldolgozású termék*"; foreign content, packaged in Hungary). Please note that maintaining such labels is

[31] European Commission, 'State aid No SA.39235 (2015/C) (ex 2015/NN) – Hungarian Advertisement Tax' C (2015) 1520 final.

[32] 'Hungary's Szemerey plans to build on MKB investment' (*Reuters*, 27 April 2017) <https://www.reuters.com/article/hungary-mkb-ownership/refile-hungarys-szemerey-plans-to-build-on-mkb-investment-idUSL8N1HZ3WB>.

[33] 74/2012. (VII. 25.) VM rendelet egyes önkéntes megkülönböztető megjelölések élelmiszereken történő használatáról [Decree No. 74. of 2012 of the Minister on Rural Develompment on the voluntary usage of marking of foodstuff].

[34] For its role in society see Euridiké Fehér and Georgina Rácz, 'External Effects of Culture, As An Influencing Factor of Food Consumption' in *Multidisciplinary Academic Research 2012 in Prague, 6 – 7 December 2012* (1st edn, AV consulting o.s. 2012).

basically conform with EU law. However, for a shorter period of time, the government liberalized the distilling of a special Hungarian spirit called *pálinka*, making it tax free and attempted to defend this approach in the face of EU law. After the EU started an infringement procedure, changes were made on the rules but they were still not conforms with EU law.[35] The dispute between Hungary and the EU on *pálinka* was also called "Pálinka freedom fight" in domestic media.

3. The Rationality of a Closed State

One could ask, whether the actions of the government are rational or not? This article is based on the (widely supported, but also extensively criticized) presumption that there exists rationality in public policy. It is based on the assumptions of Clinton J. Andrews, namely that

> "the desire to apply rationality to public decision making is a modern desire, bundled in with other tenets of modernity. These include a faith that humankind is making qualitative progress, that there is a definable "public good, that individual actions matter, and that human inventiveness will create more good things than bad things. These tenets are by no means universally accepted."[36]

On the other hand, the quest for a kind of rationality remains. Rational choice theories dominated economics after 1950 and were surrounded by widespread disputes.[37] Frank mentions two approaches to rationality, namely the self-interest standard of rationality which "*says rational people consider only costs and benefits that accrue directly to themselves*" and the present-aim standard of rationality, according to which "*rational people act efficiently in pursuit of whatever objectives they hold at the*

[35] 'ECJ rules against tax-free exemption for pálinka distillers' (*Budapest Business Journal*, 10 April 2014) <https://bbj.hu/politics/ecj-rules-against-tax-free-exemption-for-palinka-distillers_78288>.

[36] Clinton J. Andrews, 'Rationality in Policy Decision Making' in Frank Fischer, Gerald J. Miller, Mara S. Sidney (eds), *Handbook of Public Policy Analysis: Theory, Politics, and Methods* (CRC Press 2012) 170.

[37] See Steven L. Green, 'Rational Choice Theory: An Overview' (*Department of Economics, Baylor University*, May 2002) <http://business.baylor.edu/steve_green/green1.doc>.

moment of choice." Regarding governments, the situation is more problematic: they create an agenda, and try to follow that path. In this article, it is presumed that a state's aim must be to reach public good through utility maximization,[38] which means the welfare maximalisation of its citizens. This can be seen from a benefit-cost analysis (Pareto model),[39] but can also be interpreted in a broad way, including factors other than economic interests like happiness, for example. It does not seem to be useful to make a difference between substantial and procedural matters: the final aims of the Hungarian government must be evaluated together with the techniques it uses to reach them.

It is also presumed that widespread corruption is not rational from the point of the whole society, even if it can be called rational from the point of participants (clients/agents/principals). This statement could also be criticized, but on the other hand, it is also widely accepted. Under corruption I mean the definition adopted by Transparency International, which says that "*corruption is the misuse of entrusted power for private gain… Political corruption is a manipulation of policies, institutions and rules of procedure in the allocation of resources and financing by political decision makers, who abuse their position to sustain their power, status and wealth.*"[40] This article uses the model of Downs, in the sense that it accepts the view that a "*behaviour is considered irrational when it deploys a political device for a non-political purpose*."[41] This could be the case of state capture, if the intention of state legislation is solely to make profit for some private companies, and the same is true if these companies repay a part of the profit for parties in the government. The reason for this is that the state and governing parties cannot be egoistic in the sense consumers are in their everyday (rational or irrational) choices. Consequently, we can agree with Rico Grimm that "*corruption is bad and needs to be fought against*".[42] As a counter argument Huntington suggested that corruption can serve social interests, for example it can

[38] See ibid 47.

[39] Itzhak Gilboa, *Rational Choice* (MIT 2010) 85.

[40] See Transparency International, 'The Anti-Corruption Plain Language Guide' (28 July 2009) <https://www.transparency.org/whatwedo/publication/the_anti_corruption_plain_language_guide>.

[41] Rico Grimm, 'Rational Choice and Anti-Corruption-Strategies' (Essay, University of Mannheim 2009) 5.

[42] ibid 3.

solve problems raised by a dysfunctional bureaucracy or the increase of useless laws, and thereby it keeps society and economics running.[43] On the other hand, there seems to be a consensus that widespread corruption and state capture for a long term is harmful and as such, it is irrational, since it cannot serve general interests for a longer time. Another counter argument is, as Frank suggests, that in certain countries politicians with certain ideological predispositions would be unlikely to occupy their positions of leadership. He says that *"mediation attempts that focus on asking each leader to be reasonable"* would therefore seem to be doomed to failure. However, we believe the governing parties could be elected without corruption in Hungary in a democratic way either. On the other hand, leaving nationalistic rhetoric would surely cost votes. Finally, it must be highlighted that in this article we try to track the public interest, and not the rationality of certain business groups or parties. Thus, when rationality is mentioned, we will try to focus on the state's role as the main actor in defining public policy.

The government's motivations could be divergent: beside protecting local businesses and trying to help citizens with incentives, political motives or the interests of a small elite of companies can mix with national(istic) pride. The allocation of incomes can also be divergent, and it is not our purpose to create one sole model for it: however, if an action is beneficial only for a certain group and creates bad conditions for the majority of citizens, it can be called irrational. There are cases that possess a rational element while deemed legal from the point of EU law. Yet others are illegal, irrational and unjust towards foreign companies or a group of domestic companies. In all cases, judging these measures is problematic and in several instances subjective. For example, a new measure may be rational from a commercial point of view, but may pose the danger of the EU instigating an infringement procedure because of a breach of the above-mentioned EU laws. Corruption can be profitable (and therefore rational) in the short term for employees who receive jobs and benefits and companies developing faster, but in the long term, it destroys competition and can result in the stopping of EU funding. Laws discriminating against foreign companies could be beneficial for local companies, but may lead to a decrease in foreign investment – therefore,

[43] Grimm (n 41) 13 cites Huntington, Samuel P., 'Modernization and Corruption' in Arnold J. Heidenheimer (ed), *Political Corruption: A Handbook* (2nd edn, Transaction Publishers 1990).

this aspect must also be taken into consideration as part of the rationale. Still, rather than merely accept that all of nationalistic and dubious measures are wrong, we have to look deeper and try to separate legality and economic rationality in order to build a better picture. When certain EU rules are not enforced and there are no sanctions for breaching them, it may be rationally sound for a country to break them (even if not morally or legally justified, but those are entirely different issues). For example, in theory, a rational and illegal measure would be to discriminate against certain foreign companies. Using this, domestic companies could be given a push in domestic markets. We see measures manipulating the frameworks of the free market in other countries, too. For example, according to press news related to the Juncker scandal, Luxembourg provided illegal incentives for certain foreign companies:[44] it is only the selection of the group of companies and the incentives that differ. Maintaining such an arrangement becomes irrational if sanctions are introduced against the country by the EU, or if they negatively impact the country.

4. The Historical Roots of Exclusion

The roots of exclusion from the market in Hungary has great historical preludes. Such preludes were present in the different forms of European nationalism, and we also have similar preludes in Hungary, too.

First of all, nationalism mixed with exclusion of foreigners in Europe is political tool which did not disappear after WWII. We have seen that European societies tend to react very strongly when they get into interactions with other countries or representatives of other countries (and, under representatives, at this point I also mean foreign businesses). This attitude could be seen during the recent refugee crisis as well: right wing demagogue political forces were able to convince many of their truth, and were able to spread widespread hate in certain countries. The roots of this exclusion is the anti-enlightment tradition Zeev Sternhell mentions in his book on The Anti-Enlightment Tradition.[45] This attitude denies the

[44] 'Juncker "serene" over Luxembourg tax scandal' (*EU Observer*, 6 November 2014) <http://euobserver.com/political/126409>.

[45] Zeev Sternhell, *The Anti-Enlightenment Tradition* (YUP 2009). For different opinions about the effect of enlightenment see Isaiah Berlin, *Freedom and Its Betrayal* (PUP 2002); Isaiah Berlin, 'The Counter-Enlightenment' in Henry Hardy (ed) *Against the*

universality of human rights and individualism, and as such it denies the achievements of the Enlightenment. This thinking has its roots in feudalis, the oppression of a feudalistic elite and a desire to return to them. Historically, it formed the most important fundament of right-wing authoritarian regimes – whether we talk about Mussolini's Italy, Hitler's Germany or Franco's Spain. Of course, oppression in Hungary is not at the level of these states, but it already reached the level of an electoral autocracy (an autocracy behind the façade of democracy).[46] Countries between democracy and dictatorship cause a lot of analytical problems in political studies, especially for those studying and researching transitology, the area which describes the states' change from democracy to dictatorships, and vice versa.[47] Nowadays it seems obvious that we did not reach the end of times, in which democracies could prevail.[48]

Based on the above, one can easily ascertain that exclusion of foreigners from domestic markets resembles to earlier European history. In such economic systems the state opens the doors for local economic

Current: Essays in the History of Ideas (Pimlico 1979); William A. Galston, 'Moral Pluralism and Liberal Democracy' (2000) 17 (1) Social Philosophy and Policy 255; William A. Galston, 'Moral Pluralism and Liberal Democracy: Isaiah Berlin's Heterodox Liberalism' (2009) 71 (1) The Review of Politics 85, 92; Theodor Adorno and Max Horkheimer, *Dialectic* of *Enlightenment* (SUP 2002), Renzo de Felice, *Fascism* (Transaction Pub 2009) 15 (Introduction by Michael Arthur Ledeen); Stanley G. Payne, 'Historical Fascism and the Radical Right' (2000) 35 (1) Journal of Contemporary History 109, 111; Reinhart Kosseleck, *Critique and Crisis: Enlightenment and the Pathogenesis of Modern Society* (MIT Press 1988).

[46] Andreas Schedler, *The Politics of Uncertainty: Sustaining and Subverting Electoral Authoritarianism* (OUP 2013).

[47] See e.g. Samuel P. Huntington, *The Third Wave: Democratization in the Late 20th Century* (UO Press 1991); Juan J. Linz and Alfred C. Stepan, 'Toward Consolidated Democracies' (1996) 7 (2) Journal of Democracy 14; Seymour Martin Lipset, 'Some Social Requisites of Democracy: Economic Development and Political Legitimacy' (1959) 53 (1) The American Political Science Review 69; Dankwart A. Rustow, 'Transitions to Democracy: Toward a Dynamic Model' (1970) 2 (3) Comparative Politics 337; Fareed Zakaria, 'The Rise Of Illiberal Democracy' (1997) 76 (6) Foreign Affairs 22; Fareed Zakaria, *The Future of Freedom: Illiberal Democracy at Home and Abroad* (W. W. Norton & Company 2007); Juan J. Linz and Alfred Stepan, *Problems of Democratic Transition and Consolidation: Southern Europe, South America, and Post-Communist Europe* (JHU Press 1996).

[48] Francis Fukuyama, *The End of History and the Last Man* (Free Press 1992); Francis Fukuyama, 'The End of History?' (Summer 1989) The National Interest No. 16, 3.

elites with particular interest, which compete for wealth. Regarding Hungary, Bálint Magyar calls the conglomerate, in which private interests mix with the state and a group of elite party members a Maffia State.[49] A similar idea was very well explained by Guenter Reimann in his excellent book 'The Vampire Economy – Doing Business Under Fascism', which was first published in 1939.[50] Talking about foreign trade, he wrote that

> "the State-regimented foreign trader plays a dual role - he appears as a private businessman, signing contracts in the name of his "private" firm. But the fulfilment of his contracts, his buying and selling policies, depend neither on his own free will nor on the international customs and laws which were valid in a free competitive world economy. Whether fulfilment of contracts can be guaranteed or violation of contract can be prosecuted depends to a large extent on the government's decision and on the political power of the State."[51]

In the recent years, many government friendly businessman gained an extreme amount of assets in Hungary, controlling many of the major sectors in the country.[52]

Second, Hungarian history also has a strong determinating factor. If we accept the view of social constructionism that the discourses of people and organisations in micro level create their concept about the surrounding world,[53] and as such, they also create their state and foreign relations of that state, it seems plausible to state that Hungarian citizens and political actors re-create their historical past. In other words, it seems that political culture has a determinating role in state actions. Exclusion

[49] Bálint Magyar, *Post-Communist Mafia State: The Case of Hungary* (CEU Press 2016).

[50] Guenter Reimann, *The Vampire Economy – Doing Business Under Fascism* (Vanguard Press 1939), see <https://mises.org/library/vampire-economy>.

[51] ibid 217.

[52] Bart Staes and Benedek Javor, 'Orbán bites the European hand that feeds his oligarchs – it's time to bite back!' (*Euractiv*, 26 October 2016) <https://www.euractiv.com/section/central-europe/opinion/orban-bites-the-european-hand-that-feeds-his-oligarchs-its-time-to-bite-back/>; Neil Buckley and Andrew Byrne, 'Viktor Orban's Oligarchs: A New Elite Emerges in Hungary' (Financial Times) <https://www.ft.com/content/ecf6fb4e-d900-11e7-a039-c64b1c09b482>.

[53] Peter L. Berger and Thomas Luckman, *The Social Construction of Reality* (Penguin Books 1966).

and post-feudalistic elitism seems to be rooted in domestic culture, and is also strengthened by the educational system. In this state, between WWI and WWII, destitute villains remained in poverty (formally they were free, economically they were not), and nobility was able to keep its positions based on land for longer than in Western Europe. This means that feudalism lasted basically longer than in Western Europe. Beside the old nobility, however, a new mobility was also created, which was strongly dependent on state actors. A good example for this is the "Vitéz Order", which was a noble order given by Governor Horthy between the two world wars, and which also served to create a kind of new elite based on loyalty to the Governor. This elite received the title "Vitéz" and also some assets (i.e. land) from the Governor, and its members were loyal to him. Very similar ties exist today, but now loyalty to the party and certain party members (and especially its leader) is required. Furthermore, traditional xenophobia can also be used at the level of rhetoric against foreign companies. In this regard, the fact that domestic industry is weaker and is in a vulnerable position compared to Western Europe also makes defense of free market harder.

5. Why the System of Favoritism Can Hardly Be Called Rational

We have to notice that the above mentioned issues are not sporadic problems, but part of a system which openly favours certain domestic businesses and pushes certain foreign businesses out of the market. These are carefully planned laws, which serve the interests of niche domestic groups, and are obscured by a veil of mythical nationalism. However, the discrimination between foreign and domestic businesses, and in certain instances also between groups of domestic businesses could be labelled irrational because of several points.

Firstly, such an attitude could harm international relations of a country. It seems obvious that for a long term, countries which are not loyal to others (or at least do not have alliances) could alienate themselves in EU politics. This is especially so regarding smaller countries with weaker economics. Of course, one could argue that the answers of the Commission were very weak and arrived far too late, and also that Fidesz, the governing party has strong allies in the European People's Party.[54] It

[54] Agata Gostyńska-Jakubowska, 'Why the Commission is Treating Poland More Harshly Than Hungary in Its Rule of Law Review' (*Centre for European Reform*, 4 February

was obviously a deliberate strategy of the Hungarian government to act against EU rules, because it believed some of those laws could be bypassed without serious consequences (and from this point, some of the introduced laws do not seem irrational. Why not breach EU law if there is no strict answer to such breaches?). If a government is allowed to introduce measures for up to 2 to 3 years to break foreign businesses, it can boost its strategy by moving into illegal territory. Over 2 or 3 discriminatory years some foreign businesses may go bankrupt or leave the country. Moreover, in many instances it is unclear why the Commission has not instigated procedures. The website of the Commission is also not informative: we cannot see properly when and what procedures have been started; some actions have been stopped but we cannot tell when and why this has happened. Such a setup does not serve transparency: the European public deserves to be informed of actions related to governments, and also must be able to check documents related to such actions. Law should be separated from politics, and transparent mechanisms need to be applied.

A good example for the shady actions can be seen in an article written by MEP Lambert van Nistelrooij, who expressed the same problems:

> "In 2010, the Hungarian government introduced ownership restrictions on pharmacies, requiring pharmacists (virtually all of whom are Hungarian) to become majority owners and thereby forcing investors (many of whom are from other member states) to transfer their shares and relinquish control over their investments…
>
> Despite being in possession of compelling evidence, the Commission has not taken the case forward in the past two years and a half: the letter of formal notice has not advanced to a reasoned opinion, even after the Commission found Hungary's justification for its measures insufficient and in the absence of changes in factual and legal circumstances…
>
> What is particularly disturbing about the infringement case on pharmacy ownership restrictions in Hungary is that there are indications that political interference has taken place and that the Commission's independent assessment of the situation has been compromised. I have made an inquiry about this to the Commission through a written question.
>
> As I explained in the question, Mr Orbán's chief of staff, Minister Lázár, travelled to Brussels to meet Commission officials in February 2017.

2016) <http://www.cer.eu/in-the-press/why-commission-treating-poland-more-harshly-hungary-its-rule-law-review>.

> Following his undisclosed meetings, he told the press that he had "reached common grounds" with the Commission on several infringement cases, "including on pharmacies."[55]

The fact that the application of EU law is subject to negotiations does not serve enforcement of EU law provisions domestically.

This leads us to the second disadvantage, namely, to the disrespect of laws. No country is able to function without laws. If a state intentionally starts to disrespect laws it could have a devastating effect on its society as well. Institutionalised corruption built in laws could have an effect on everyday actions, and it could lead to wider disrespect of laws and the rise of everyday corruption, even among small and medium size enterprizes. Regarding legality, it must get mentioned that the Council of Europe also noticed that corruption could cause problems. In one of its its latest report, GRECO (The Group of States against Corruption established in 1999 by the Council of Europe) wrote that:

> "*several measures are needed in order to enhance the overall transparency of the legislative process as applied*", and it recommended "*(i) to ensure that all legislative proposals are processed with an adequate level of transparency and consultation and (ii) that rules be introduced for members of parliament on how to interact with lobbyists and other third parties seeking to influence the parliamentary process*".[56]

An analysis of PriceWaterhouseCoopers already proves some of the problems such an attitude could strengthen: for example regarding economic crimes, 36% of companies would allow a worker committing a crime in connection with his work to stay at the company (in Eastern-Europe the average is 74%) and only 45% would turn to authorities in such cases (the Eastern-European average is 56%).

[55] Lambert van Nistelrooij, 'Problems with Hungary affect EU single market too' (*Euractiv*, 26 April 2017) <https://www.euractiv.com/section/justice-home-affairs/opinion/problems-with-hungary-affect-eu-single-market-too/>.

[56] <http://www.coe.int/t/dghl/monitoring/greco/evaluations/round4/Eval%20IV/GrecoEval4Rep%282014%2910_Hungary_EN.pdf>

Moreover, Hungarian companies also tend not to pay their debts, and one could argue that liquidity is only a minor cause behind this:

> "More than 75 percent of businesses in Hungary and 63.1 percent in Poland are impacted by domestic customers' insufficient funds - the highest rates in Eastern Europe… Foreign payment delays driven by liquidity issues were reported most often in Hungary and Slovakia, both at rates hovering around 50 percent."[57]

If obligations can be disregarded by the state, or major actors in domestic business, small and medium enterprises will also follow this line of thinking.

Third, the actions seem to be irrational from an economic point of view as well. "*In Hungary, currently, foreign owned companies employ over 20 percent of labour force in manufacturing, produce over 50 percent of manufacturing GDP and 85 percent of total Hungarian exports.*"[58] Hungarian companies, especially enterprises created for a short term to receive incentives from the state will not be able to take over their role. Moreover, the amount of foreign direct investment (FDI) could also decrease. There was a strong drop in FDI in 2013, but this also affected other Eastern European countries such as Slovakia and the Czech Republic. A stronger net outflow happened in 2014:[59] in the first three quarters of 2014, there was a decrease in foreign investments of about 1.600 billion forints. Recent news suggested that if we do not add refinancing activities of banks in the country, the FDI is moving heavily into negative, and this is only hidden by the Government manipulating the

[57] Doug Collins, 'Eastern European Outlook - Improving Economies, Deteriorating Payment Practices' (*Global Trade*) <http://www.globaltrademag.com/global-trade-daily/eastern-european-outlook>.

[58] CUTS Centre for Competition, Investment & Economic Regulation, 'Investment Policy in Hungary Performance and Perceptions' (2003) CUTS Discussion Paper, 9 <http://www.cuts-ccier.org/pdf/Investment_Policy_in_Hungary%E2%80%93Performance_and_Perceptions.pdf>.

[59] Blahó Miklós, 'A multiellenes és multipárti politika egyenlege negatív' [The balance of anti- and pro-multinational company rhetoric is rather negative] (Világgazdaság, 30 October 2014) <http://www.vg.hu/vallalatok/a-multiellenes-es-multiparti-politika-egyenlege-negativ-438020>.

concept of FDI.[60] Evidently, an authoritarian political system eventually risks an intensive outflow of foreign capital. A reason for the strong capital outflow observed could also be instability (such as unpredictable tax changes) and the discriminatory nature of the business environment. PM Orbán has declared that he desires an "illiberal state", one that is "perhaps not even a democracy", and that he finds Russia, China, Turkey and India to be good examples of such a system because they serve the needs of post-crisis economies better than traditional democracies.[61] However, deeper research into a pool of 155 countries shows that the "*length of time a country is not subject to authoritarian regimes is positively related to economic growth and the level of per capita income*" and also that "*countries with an autocracy for the average number of 36 years had GDP per capita that was approximately 25% lower than non-autocratic countries, all other things remaining equal*".[62] Clearly, in the long term, the legal frameworks underpinning a market must be free and competitive for it to function well. "*Institutional knowledge takes time to evolve for it to be fully complementary to quality market based institutions*".[63] If there are too many discriminatory measures, the country will not "train" its companies and people to compete, and this will have a negative effect on domestic businesses. Thus, national identity and nationalism may come to a head with economic rationality. The problem this brings is that it can cause foreign capital to leave the country, making domestic industry less competitive. In some areas, Hungary has already achieved as much as it could: for example, around 80% of foodstuffs sold in the country is already domestic product.[64]

[60] Gábor Oblath, 'Működőtőke-áramlás, újrabefektetett jövedelem és a nettó külföldi vagyon változása Magyarországon – Statisztikai adatok, módszertani kérdések és értelmezési buktatók' [Working capital flow, reinvested capital and changes in the net foreign capital in Hungary – Statistics, methodological questions and difficulties in interpretation] (2016) 94 (8-9) Statisztikai Szemle 821.

[61] The Editorial Board, 'A Test For the European Union' (*The New York Times*, 1 August 2014) <http://www.nytimes.com/2014/08/02/opinion/a-test-for-the-european-union.html?_r=0>.

[62] Art Carden and Harvey S. James, Jr., 'Time Under Authoritarian Rule and Economic Growth' CORI Working Paper No. 2007-02, 11 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1010748>.

[63] ibid 12.

[64] According to a survey conducted by Corvinus University (Budapest) in 2010, the proportion of food products produced or processed in Hungary in domestic retail was

Fourth, the idea of a discrimination can have a bad effect on political culture. Even apart of the overall changes in the Hungarian legal system in the last years, some of the legislation regarding single market rules breached basic constitutional principles and conflicted with either the Fundamental Law of Hungary, the European Convention on Human rights, or both. Moreover, discrimination can have a spill-over effect on other field of law as well

Fifth, the actions can have even broader social implications. Since acquiring assets is dependent on the state, more and more people will get excluded of mainstream social life and social mobility is very low.[65] This means that the post-feudal, post-authoritarian society structure, in which poor people cannot better their situation through work and studying and the elite receives its position and partly also its assets directly from the government remains conservated for decades. It seems that the society is in a relatively vulnerable position compared to other European states, as gross average wages are among the lowest in the European Union.[66] Moreover, even though Hungary had a relatively stable economic position among the former communist countries in 1990, it became the second poorest country in the European Union.[67]

Sixth, such a country, for a long term, will also lose human capital. Around 700.000 Hungarians have left the country already, which is very high, compared to the relatively low mobility of Hungarians earlier.[68] A part of the elite already left the country, and the attraction ability of the country is also get reduced. As David Law suggests,

76.45%. The research has shown a somewhat lower proportion at international supermarket chains (72.8%) than at domestically owned stores (82%). See 'Többségben a magyar élelmiszer a kereskedelmi láncok polcain' [Most Foodstuffs on Hungarian Supermarket Shelves are Hungarian] (*Trade Magazin*, 9 November 2010) <http://www.trademagazin.hu/hirek-es-cikkek/piaci-hirek/tobbsegben-a-magyar-elelmiszer-a-kereskedelmi-lancok-polcain.html>.

[65] <https://www.eurofound.europa.eu/sites/default/files/ef_publication/field_ef_document/ef1664en.pdf>

[66] For OECD's statistics see <https://data.oecd.org/earnwage/average-wages.htm>.

[67] Eurostat, 'Consumption per capita in purchasing power standards in 2017' Newsrelease 192/2018.

[68] Károly Beke, 'Ide vezetett a tömeges kivándorlás: több magyar lépett le, mint gondoltuk' [The mass-emigration led hereto – More Hungarian left than we have thought] (*Portfolio*, 30 August 2017) <http://www.portfolio.hu/gazdasag/ide-vezetett-a-tomeges-kivandorlas-tobb-magyar-lepett-le-mint-gondoltuk.1.260665.html>.

> "economic globalization includes competition among nations for investment and human capital. Under this view, nations compete by offering investors and those with high levels of human capital – the well-educated and highly trained – attractive packages of benefits. An important component of those packages, Law argues, is constitutional protection [...] When considering where to place their capital, investors will consider the likely returns on their investments and [. . .] to maximize their risk-adjusted returns."[69]

In this thinking, interests of human capital go hand in hand with personal choices. He also uses a nice example to show the more holistic approach of companies.

> "Consider an investor choosing between two nations. One nation offers a relatively high rate of return, but does not guarantee that the investor will actually be able to realize the returns due to a constitutional provision authorizing the government to expropriate investments and returns at will. The second nation offers a slightly lower rate of return. Depending on the size of the gap and the likelihood of expropriation in the first nation, however, the second nation may be able to attract the investment by coupling the lower rate of return with an assurance that the returns will actually be realized."[70]

This is especially true, if government ministers start a campaign against companies which try to enforce EU law.[71]

Seventh, disrespecting EU law could lead to changes in the EU as well. If we accept the view of neo-functionalism[72] that the development of European cooperation was built on spill-overs from areas to other areas (e.g., if we give the right of free movement for persons, we have to solve issues like cross-border crimes), one could also reverse this claim, and

[69] Mark Tushnet, 'The Inevitable Globalization of Constitutional Law' (2009) 49 (4) Virginia Journal of International Law 991.

[70] ibid.

[71] 'Lázár: Philip Morris, Spar are behind EC probes' (*Budapest Business Journal*, 17 July 2015) <http://bbj.hu/politics/lazar-philip-morris-spar-are-behind-ec-probes_101068>.

[72] Ernst B. Haas, *The Uniting of Europe: Political, Social, and Economic Forces, 1950-1957* (Stanford University Press 1958).

suppose that a kind of negative spill-over could also occur in Europe. Certain countries could start a process, in which they disobey certain laws of the EU, which spreads to other countries, and finally also takes place at the EU level as well. A perfect example for this could how the rules of domestic products got changed in the last years,[73] and certain Commission guidelines are not followed at all in practice.[74] We had very similar tendencies regarding the free movement of workers and in the field of EU refugee law as well. One country or a group of countries can convince others not to follow the rules set earlier, and this fact contains great dangers, since, through disobeying rules, the frameworks of cooperation may fall apart. Furthermore, according to Kolsky, protectionist measures may lead to other countries adopting market-restricting measures, causing recession in Europe.[75]

Hungary has had a unique path to democracy and market economics. However, ethnocentrism in itself will not be able to build successful economics, and it seems that it is a rather irrational path serving only the interests of the government's clientele. Members of this group are actively involved in this state capture, which is unable to serve the purposes of everyday people. On the other hand, without knowing its competitors (countries as well as businesses), without having a stable legal and tax system, the country will not be able to develop. This process will inevitably result in an underperforming economy and lead to poverty. This is especially true when actions are illegal apart of 'simply' being irrational, because it pushes the government into a spiral of international isolation, which impacts businesses and private persons as well.

[73] Janja Hojnik, 'Free Movement of Goods in a Labyrinth: Can Buy Irish Survive the Crises?' (2012) 49 (1) CMLR 291, 322 ff.

[74] European Commission, 'Commission communication concerning State involvement in the promotion of agricultural and fisheries products' [1986] OJ C272/3; and a different approach in Commission, 'Green Paper on promotion measures and information provision for agricultural products: A reinforced value-added European strategy for promoting the tastes of Europe' COM(2011) 436 final.

[75] Meredith Kolsky Lewis, 'The EU's Protectionism Problem' (2009) 10 (2) Georgetown Journal of International Affairs 23, 28.

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Short biography of the author(s)

Tamas Dezso Ziegler graduated from Pázmány Péter Catholic University (dr. jur.), received his PhD from Széchenyi István University, and completed his habilitation at Eötvös Loránd University. He is currently a research fellow at the Hungarian Academy of Sciences and an associate professor at Eötvös Loránd University. His major is EU/comparative commercial law, justice and home affairs, and EU private international law. He has hold various visiting positions at Bergen University, Northwestern Politechnical University (Xi'an), Free University Berlin, Max Planck Institute for Comparative and International Private Law, Max Planck Institute for Comparative Public Law and International Law, CNR Institute for international legal studies (ISGI) (Rome), Swiss Institute of Comparative Law, Fordham University School of Law, Columbia University, and the University of Aberdeen. In practice, he has been working for OSCE (ODIHR), and Baker & McKenzie, among other major law firms.

Annex

The Centre for European Studies (CES) at the Széchenyi István University

László Milassin*

The Jean Monnet Programme

In 1989, the European Commission launched the Jean Monnet Action to support academic research in European integration. The programme originally addressed academics in the Member States, but came to include those in accession countries soon after. Today, it has a global scope and offers worldwide support to European integration studies.

The most important modes of support have been grants for the development of teaching modules in European integration studies, the designation of Jean Monnet Chairs and financial support for Jean Monnet Centres of Excellence for teaching and research. Networking activities and other research activities are supported too. Cooperation across different institutions and with partners outside higher educations is encouraged.

Grants are a trigger for the development of initiatives, in spite of their modest value and dependency on co-funding. Strong support from the university management is a must because grantees are required to continue activities for a number of years after support has ceased.

Over the years, interdisciplinary has come to grow in importance and is now actively promoted. Indeed, a solid understanding of European integration requires insight from history, politics, economics, law and other disciplines.

The current and former Jean Monnet Chairs form a very strong professional network. Being awarded a Jean Monnet Chair is seen by

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many as a valuable entry ticket into the international community of European integration researchers.

European Study Centres in Hungary

In 1998 the Hungarian Representation of the European Commission (DG 10) and the Hungarian Ministry of Foreign Affairs concluded an agreement on establishing 14 European Study Centres with the support of PHARE aid. The European Study Centres were established as parts of 14 Hungarian state accredited universities. Today there are 17 European Study Centres in Hungary. In 2000 the European Study Centres were coordinated by the TEMPUS Public Foundation which elaborated a programme with remarkable results: more than 30.000 undergraduate students, 3.500 graduate students, and 7.000 experts from target group institutions (teachers, entrepreneurs, lawyers, journalists and civil servants) had been trained by more than 600 lecturers.

The main tasks of ESC:

- Teaching of EU modules (EU Law, economic and political integration, history of the European Institutions, etc.) at the faculties on different levels.
- Teaching of European studies in the postgraduate education.
- Training and further educations to experts, businesspersons, officers, attorneys, media specialists and high school teachers.
- Research programs (PhD and other research activities).
- Network building activities (ESC, regional, sectorial and partnership cooperation).

Centre for European Studies at the Széchenyi István University

The European Study Centre of Széchenyi University was established in 1998 too. It focused on the teaching modules which covered the most important knowledge about European integration. The study centre became a real regional centre. Our study centre cooperated very close with the local authorities organizing lectures for civil servants, business professionals and secondary school teachers in the region.

The teaching activities of our centre covered the following subject: case law of the EU, European internal policies, IT law and legislation of the EU, regional politics of the EU, EU project planning, developing the rural

regions in the European Union, European security and defense policy, European transportation infrastructure, EU traffic, tariffs and customs, and development of small regions in the EU. We published a newsletter monthly on European Law.

Since 1998 we have a Jean Monnet Chair at our Faculty of Law. Wee participate actively in the Jean Monnet and ERASMUS+ programmes. Our study centre cooperated and cooperate with the following foreign partner institution: University Vienna Juridicum, University Strasbourg, University Sapientia, University Brno, University Krems, University Jules Verne France, University Passau Germany, University Saarbrücken, etc.

EUBLAW - Jean Monnet Module on EU Business Law (2016-2019)

In 2016 the Centre for European Studies obtained funding for the "Jean Monnet Module on EU Business Law" (EUBLAW) project within the framework of the Erasmus+ programme of the European Union. The main objective of the project concerns comprehensive curriculum development in the field of EU Business Law at the Deák Ferenc Faculty of Law of Széchenyi István University. The project aims at elaborating the scope and content of complex course structure, establishing the methodology of the courses, composing of 2 elective courses announced in English. The new courses will be announced for students attending MA law, for incoming Erasmus-students of the Faculty and also interested students in international administration and economics will have the opportunity to participate. The team members will elaborate up-to-date course materials, including systematised course presentations and a concise course book in English in order to foster the publication and dissemination of the results of academic research conducted within the three years long project. The main aim of the project is to deliver tailor-made courses for the participants and for that reason, the teaching methodology will also apply innovative approaches. The Jean Monnet Module will be predominantly based on the 'law in context' approach and will offer a perspective behind the text of law in order to equip students with the ability to understand the real function of the legal instruments governing the business relations within the EU internal market. In this way, the project is expected to improve teaching capacities in the field of EU Business law in English at the Faculty, as well as to provide quality course materials. The Jean Monnet Module will be carried out within the infrastructure of the Centre for European Studies, therefore the project

might give also new impetus to this research institution of the Faculty established within a former PHARE project in 1998. Moreover, as an expected post-grant impact, the project outcome might contribute to the accreditation of a post-graduate course (LL.M.) for legal professionals as well.