# EVOLUTION OF PRIVATE LAW

## NEW APPROACH

Uniwersytet Śląski
OFICYNA WYDAWNICZA
2016

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## NEW APPROACH

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# INTRODUCTION

The publication "Evolution of Private Law - new approach" is an effect of the international cooperation between the Department of Commercial Law at the Faculty of Law and Administration at the University of Silesia and representatives of foreign university departments of private law from Czech Republic, Slovakia, Italy and Ukraine. It continues the collective publications, edited 2014 and 2015. The cooperation resulted also in organizing two international conferences held at the Faculty of Law and Administration in Katowice. As in previous years also this year's edition of the conference will take place in Katowice.

The wide formula of the academic cooperation embraces an analysis of the new trends in company law, contract law and other branches of private law, therefore this publication examines different aspects of the evolution of private law and allows the authors to present their opinions.

This year's edition is dedicated to the new approach of the legal regulations concerning private law in the European Union in comparison to the law systems in other European countries. A broad range of authors, academics from Polish and foreign universities alike, contributes substantially to strengthening the comparative law research.

This publication is dedicated primarily for civil law academics but it also addresses the issues relevant to the legal practice. Most of the articles can be useful in the didactic process at law studies as well.

# LEGAL ISSUES OF COMPANIES

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# GENERAL DESCRIPTION OF TRADING IN THE LAW OF CAPITAL MARKET

## Company Listing (Public offering) Admitting Securities into Official Trading

As an issuer interested in gathering funds through issuing new financial instruments (e.g. shares as securities) on the capital market, a joint-stock company must make a public offer for the acquisition of its financial instruments. Such an offer is usually connected with increasing the company's share capital, as it refers to the issue of new shares[1]. Making such an offer is preceded by a complicated process comprising a range of various activities, both internal (e.g. adopting resolutions of the competent corporate bodies, such as a resolution of the General Shareholders Meeting on increasing the share capital), and external (e.g. concluding agreements on servicing the issuer during the process, with an investment company, with an auditor, with an investment advisor, with a legal counsel and with an advertising agency).

The preparation of a public offering requires establishing the legal and economic standing of the issuer[2], as well as analysing the offer

[1] A company may adopt various strategies of entering the market (to be listed). Its public offer may comprise, for instance, the issue of new shares (the company receives new funds for the share capital this way), the public sale of already existing shares (persons entitled to benefiting from shares may this way dispose of the shares they hold, either for profit or to exit the company), listing shares on the stock exchange without a public issue (usually to increase the company's prestige) or a compilation of these possibilities. In addition to shares, a company may also publicly offer convertible bonds or other financial instruments.

[2] Taking into account the importance of the proper assessment of the company's financial and legal standing, the audit process should be performed with the utmost diligence. Therefore it is referred to as due diligence.

itself, including the choice of financial instrument subject to the public offering, along with the conditions of its acquisition[3]. An entity conducting stockbrokerage activity (an investment company) and an auditor are the two necessary facilitators in these proceedings, as they are obligatory by law. An investment company usually participates in preparing the company to be listed from the very beginning of the process, i.e. from developing the strategy of entering the regulated market (the issue programme)[4], through developing and drafting information documents (the issue prospectus), the procedure of approving the issue prospectus by the Polish Financial Supervision Authority (PFSA), and finally, performing and the settling the offering and listing the company for trading[5]. An investment company also finally offers the financial instruments of the issuer on the market. Therefore, the investment company tends to be referred to as the issuing house. At the same time, the participation of an auditor in the process of listing the company is intended to ensure that the financial information made public in the company's information documents is true and fair, especially the information included in the issue prospectus, which forms the main document based on which investors will make their investment decisions.

Gathered and confirmed information is included the issue prospectus (or in another document performing a similar function, e.g. a memorandum of information)[6], which is subject to the approval procedure by the PFSA prior to being published[7]. The decision on approving the issue prospectus is generally issued by the PFSA within 10 business days from the date of filing an application. However, if the issue prospectus refers to the securities of an issuer who has never offered any securities issued and subscribed so far in any public offering, and if these securities have not been admitted to trading on the regulated market, the PFSA issues its decision within 20 business days from the date of filing the application. If the issue prospectus does not meet the requirements set out by the provisions of law, if the submitted documentation is incomplete, or if obtaining additional information is necessary, within the scope necessary for approving the issue prospectus, then the PFSA may demand that the information published in the issue prospectus be supplemented or changed, or that other documents and information regarding the financial or legal standing of the issuer be presented or included in the issue prospectus. In addition, the PFSA may demand that additional information be included in the issue prospectus. The application to approve the issue prospectus may be refused if the prospectus does not meet the requirements specified by the provisions of law with regards to its form or content. In addition, upon the approval of the issue prospectus by the PFSA, the issuer is obliged to permanently and immediately inform the PFSA about any events or circumstances that could have a material effect on the perception of the financial instruments offered publicly by the issuer[8].

Upon the approval of the prospectus, the issuer performs the public offering and collects subscriptions for the new issue of shares. Before making a public offering, it is in the interest of the issuer, but also to the benefit of investors, to announce the scheduled issue. Announcing information about the issue is referred to as the issue promotion. Securities offered by the issuer, as with any other commodity, should be advertised in order to drum up interest among investors in the issuer, in the securities being offered and in the content of the offer. The issuer often conducts market research to gauge interest in its offer, while drafting the offer content, particularly the price of shares, the number, the date of commencing subscriptions for shares,

[3] Also arrangements regarding the time limit for the public offering, the amount and value (issue price) of the offered shares, as well as the group of addressees of this offering (the "offerees"), are extremely important.

[4] Including also establishing the structure of the issue, creating book building, the issue price for the offered financial instrument etc.

[5] An investment company cooperating with the particular issuer is also referred to as the issue sponsor. This term may be misleading as it is not about sponsoring the issue, but about maintaining the register of subscriber of the new issue shares offered within the initial public offering or within primary trading. The maintained register becomes part of the depository-settlement system, upon the registration of securities in the KDPW.

[6] The obligation to prepare, approve and make public the issue prospectus exists, as a rule, in the case of an initial public offering, a public offering and in proceedings on admitting securities to trading on the regulated market.

[7] An application for approval of an issue prospectus or information memorandum (or an application for confirmation that the information included in the memorandum complies with the information required in the issue prospectus) cannot be filed later than four months from the date of adopting a resolution on increasing the share capital.

[8] In the form of annexes to the prospectus that the issuer must submit to the PFSA no later than within 24 hours from the event, or from the occurrence of circumstances for the purpose of their approval.

and the target group of the offer addressees. This activity is referred to as the book building process. During this process, the issuer tests potential investors – checking the price they would be ready to pay for its future securities, and the amounts they would be interested in buying. Based on this, the issuer receives the information allowing it to better draft the final content of the offer (including in particular the price of the shares). As part of the book building process, the issuer may apply various loyalty programmes during the research, in return for participating in it, and it may grant specified preferences when offering securities to the research participants.

Before commencing a public offering, the issuer may also consider the need to conclude underwriting agreements[9]. These agreements ensure that the issue of securities will be effective[10]. The Capital Market Law differentiates two types of underwriting agreements: firm commitment underwriting and standby underwriting. The first one includes the underwriter (hereinafter referred to as the firm commitment underwriter) who[11] undertakes towards the issuer (or the selling party)[12] to acquire (subscribe), on its own account, all or part of the securities of a specific issue, offered exclusively to this entity with a view to reselling them in the public offering. Under a standby underwriting agreement, however, the underwriter (hereinafter referred to as the standby underwriter)[13] undertakes towards the issuer (or the selling party) to acquire (subscribe), on its own account, all or part of the securities offered in the public offering that were not subscribed for during the subscription period. Both these types of agreements,

[9] See more: M. Pawełczyk: *Gwarantowanie emisji w spółce publicznej [Underwriting in Public Company]*, Jurysta 2002, № 10; Idem: *Gwarantowanie emisji w spółce publicznej [Underwriting in Public Company]*, Katowice 2005.

[10] Selling securities under such an agreement is performed through an investment company.

[11] Only a bank, an investment company or a foreign investment company, or a consortium of such entities, may act as the firm commitment underwriter. In the case of a consortium, each entity acting as a consortium member is also considered as the firm commitment underwriter.

[12] The selling party is the holder of securities who makes a public offering.

[13] Only an investment company, an investment fund, an open pension fund, a bank, insurance company, a Polish or foreign financial institution with its registered office in an OECD member state, or subject to OECD, or a consortium of such entities may act as a standby underwriter. In case of a consortium, also each entity acting as a consortium member is considered the standby underwriter.



therefore, assure the issuer (or the selling party) that the securities they are offering will be acquired in full, so the issue will be successful. As long as the firm commitment underwriting involves subscribing for all the securities (100 per cent of the issue) by the firm commitment underwriter, the standby underwriting constitutes some kind of "supplementing interest in the issue" up to 100 per cent. If investors fail to subscribe for all the securities offered by the issuer, the standby underwriter will subscribe for the remaining part. What is important, the agreement concluded by the issuer for firm commitment underwriting should include the possibility for the firm commitment underwriter to dispose of the right to subscribe for the securities. Disposing of this right by the underwriter is considered as primary trading, even though it is actually secondary trading (investors buy securities, but not from the issuer). In addition, offering the sale of shares subscribed for in execution of this right is considered as primary trading when a registry court entered the increase of share capital of the issuer into the commercial register.

Upon announcing a public offering, which involves notifying at least 150 addressees or an unspecified addressee, with sufficient information on the securities to be offered and the terms and conditions of their acquisition to enable an investor to decide whether or not to purchase these securities, the investment company is in charge of the subscription for securities offered by the issuer. The process of subscribing for shares in a company (the shares subscription) cannot exceed three months and is subject to the provisions of the Commercial Companies Code.

Upon closing the subscription and subscribing all the shares, the issuer files an application to register the increased share capital in the National Court Register[14]. The resolution on increasing the share capital cannot be notified to the registry court more than twelve months

[14] Within 14 days from the date of completing the subscription or of the sale of securities subject to the public offer, or of admitting the securities to trading on the regulated market (or their introducing into the alternative trading system) the issuer or the party selling the securities is obliged to inform the PFSA about this fact. Based on this, the Authority enters these securities to its register (the PFSA maintains the register of securities subject to public offering and securities and financial instruments other securities admitted for trading on the regulated market or entered into the alternative trading – except for securities issued by the State Treasury and the National Bank of Poland).

(in the case of a new issue of shares subject to a public offering covered by an issue prospectus or information memorandum) after the date of the respective approval of the issue prospectus (or information memorandum) and no later than one month after the date of assigning shares. Newly issued shares are created at the moment of the registry court's decision on the share capital increase becoming valid. However, as mentioned above, a share as an object of public trading on the regulated market will be created at the moment of being registered in the National Depository for Securities (KDPW S.A.)[15].

Every security that will be subject to a public offering or is admitted to trading on the regulated market must be dematerialised. Therefore, the issuer of securities is obliged to conclude an agreement with the National Depository on registering such securities in the depository for securities. The issuer's securities are entered into special KDPW S.A. accounts (issue accounts). At the moment of concluding the agreement, the shares are subject to dematerialisation, while any entries regarding these securities made in connection with their subscription or sales in primary trading or under an initial public offering by an investment company (namely by the entities acting as stockbrokers or by custodian banks) are also considered securities accounts, as long as they identify the entities entitled to rights under the securities. At the moment of dematerialising at least one share, the company that issued it becomes a public company. A public company is a company in which at least one share is dematerialised within the meaning of the Act on Trading in Financial Instruments.

At the same time, the rights from dematerialised securities arise at the moment when they are first registered on the securities account, and the owner of this account is entitled to these rights.

The next stage in the procedure of introducing shares into public trading is proceeding before the company organising and performing trading on the particular market (the stock exchange market or the OTC market). Two sub-stages should be distinguished in this procedure. The first stage involves admitting the company to public trading, the second involves introducing its securities to trading.

[15] Hence the specific dualism of regulations – the Commercial Companies Code and the Capital Market Law (in particular the Act on Trading in Financial Instruments) with regards to creating a share as a security.



Admitting means that the company's securities meet the requirements specified in the regulations binding on the market the company aspires to be listed on (e.g. the Stock Exchange Regulations)[16]. On the other hand, introducing onto the market means establishing the start date for listing the issuer's securities on the specified market resulting in the legal and actual appearance of the securities in trading (the company's debut). It should be noted, additionally, that the legal character of both solutions, similarly to the legal character of their basis (the applicable regulations of companies operating a regulated market), causes many doubts due to their impact on third parties. The stock exchange management board adopts a resolution on admitting financial instruments to stock market trading within 14 days from the date of the interested company (the issuer) filing the relevant application. If the filed application is incomplete, or if obtaining additional information is necessary, the stock exchange management board or supervisory board may demand that the application be supplemented, or that information be presented allowing an assessment of whether the financial instruments subject to the application meet the criteria and conditions for being admitted to trading on the particular market. The stock exchange management board will refuse to admit financial instruments to stock market trading if the above criteria and conditions are not met[17]. In the case of a refusal to admit securities, the applicant is entitled to appeal against the decision of the exchange supervisory board within the time limit specified in the stock exchange regulations[18]. The appeal is reviewed within a month

[16] As described above, the financial instruments may be admitted to trading, provided that the relevant information document on them was prepared, approved by the competent supervision authority, or a relevant information document was prepared with the document equivalence within the meaning or the Act on Public Offerings was stated by the competent supervision authority, unless preparing, approving or stating the equivalence of an information document are not required, with their unlimited marketability and with no bankruptcy or liquidation proceedings pending against the issuer. Analogical requirements apply on the OTC market. The Stock Exchange management board is not required to adopt a resolution on admitting to trading financial instruments issued by the State Treasury or the National Bank of Poland. Financial instruments of these issuers are considered admitted to stock exchange trading at the moment of the issuer filing an application for admittance and entering these instruments to trading.

[17] A refusal of admission must be properly justified.

[18] It may take place within five session days from serving the resolution. The same time limit is set out in the trading regulations for the OTC market.

from being submitted. A resolution of the stock exchange supervisory board denying the appeal may be brought before the court competent for the registered office of the company operating the stock exchange market within 14 days from the date of obtaining information on the resolution, if the refusal breaches the provisions of the stock exchange regulations[19]. The court decision resulting from the statement of claim replaces the resolution on admitting financial instruments to the stock market trading[20].

Financial instruments are introduced and admitted to trading on the basis of an application of the interested company (the issuer). An application to introduce securities (i.e. the company's debut on the market) should be filed with the management board of the stock exchange company (stock exchange market) within six months from the date of receiving the decision on the admission to trading. After that time, the stock exchange management board may repeal the decision on admission[21]. Financial instruments may be introduced to stock exchange trading in the ordinary procedure or through a public offering for sale. Introducing financial instruments to stock exchange trading in the ordinary procedure is requested by the issuer in an application, indicating in particular the code assigned to the instruments under which they are registered in the depository for securities. Upon filing the application, the management board of the company operating the particular market introduces the financial instruments covered by the application into stock exchange trading, specifying in particular the stock exchange session of the first listing.

Introducing financial instruments through a public offering takes place on the basis of a sale offer made by a stock exchange member (e.g. an investment company). Financial instruments may be introduced through a public offering if the public offering includes at least

[19] A repeated application for admittance to stock exchange trading of the same financial instruments may be filed not earlier than six months after the date of being serving the resolution, and in the case of lodging an appeal, from the date of serving the repeated denial resolution.

[20] The admission to trading on the regulated market is regulated in a similar manner to the one described above.

[21] If a company with its shares already admitted to trading does not introduce stock exchange trading with its new issue shares within six months from the date of completing the subscription of these shares, or by the date when their disposing of was limited, then it is obliged to publish information on the reasons for this decision.



10 per cent of the financial instruments covered by the application for admission, or if the offering value exceeds PLN 4,000,000 in the case of financial instruments entered into trading on the prime market, or PLN 1,000,000 in the case of financial instruments introduced into trading on the alternative market. The trade participants are notified about the introduction of the financial instruments, while in the case of public offerings the notification should take place within one hour after finishing a trading session on a trading day, and no later than one hour after the end of trading on a trading day preceding the introduction date.

## Trading in Securities (in Shares)

An investor who wants to subscribe for (on the primary market) or acquire (on the secondary market) financial instruments must go to an investment company, as an obligatory broker in public trading in securities, in order to conclude the relevant agreement with it. This agreement is referred to as a brokerage agreement or a brokerage order agreement[22]. Concluding a brokerage agreement is necessary due to the principle of the obligatory assistance of a stock broker. The agreement should be concluded in writing, and in the case of an agreement concluded with a retail customer – it must be concluded in writing in order to be valid. Executing buy or sell orders on financial instruments may also involve the investment company concluding sale contracts on financial instruments with the ordering party, on its own account. In the agreement on executing buy or sell orders on financial instruments, the investment company may also undertake to:

1. accept and forward buy and sell orders for financial instruments, or

[22] See: A. Chlopecki: *Obrót instrumentami finansowymi na rynku kapitałowym [Trading in Financial Instruments on the Capital Market]*, [in:] System Prawa Prywatnego, t. 19, *Prawo Papierów Wartościowych, [Private Law System, Vol. 19, Securities Law]*, edited by A. Szumański, Warsaw 2006, p. 941, M. Romanowski, *Umowa zlecenia maklerskiego [Brokerage Order Agreement]*, [in:] System Prawa Prywatnego, t. 9, Prawo zobowiązań – umowy nienazwane, *[Private Law System, Vol. 9, Contract law – Innominate Contracts]* edited by W.J. Katner, Warsaw 2010, p. 125; ibidem: Umowa o pośrednictwo w obrocie gieldowym (zlecenie maklerskie) *[Brokerage Agreement (a Brokerage Order Agreement]*, Warsaw 2000, p. 28.

2. store or register financial instruments, including keeping a securities account, keeping collective accounts or money accounts.

The investment company providing services to the investor should, as a rule, set up two types of accounts for it: a securities account and a cash account, which is useful for servicing the securities account[23]. The securities account is an account for recording dematerialised financial instruments acquired by the investor, while the cash account is used to finance the transactions executed in connection with the acquisition of financial instruments, entered in the securities account. In the agreement on executing buy or sell orders (orders understood not as an agreement in the meaning of the Civil Code, but as a disposition) for financial instruments, the investment company may also undertake to buy or sell financial instruments on the account of the investor, who acts as the ordering party.

Under the agreement concluded with an investment company, an investor places an order, i.e. makes a disposition to perform the specified legal act on the regulated market[24] (here: on the stock exchange). Following that, an investment company performs the order (the investor's disposition) under the brokerage agreement, by making an offer applicable to the order (a buy or sell order for a financial instrument). The investment company makes the offer on the market as an obligatory stock exchange broker (under the principle of obligatory assistance of a stock broker). As a result, it is the investment company who is the party to any legal act on the stock exchange, and not the investor. While making an offer, i.e. when placing an order on the stock exchange, it acts in its own name, but on the investor's behalf. The investment company's offer is referred to as the broker's order. The casuistry of possible orders (offers) placed on the stock exchange is enormous. Without going into details, these orders may be divided according to the criterion of time, content and binding nature[25]. The criterion of time allows for orders binding the offering party to be separated for a specific time (without limitation until the specific moment of an event). Market orders and must-be-filled orders are examples of orders divided by content. At the same time, orders not subject to modification are an example of using the criterion of being bound by the order (stock exchange offer) made. Orders placed on the stock exchange (offers) are then matched by the stock exchange computer system as long as concluding a transaction meets the priorities specified by the stock exchange (e.g. regarding price[26] or the moment of placing an order – an offer[27]). It is worth stressing that the process of concluding an agreement on the regulated market differs from standard solutions assumed in the private trading market. These agreements are not concluded following any negotiations or tender process, or a proposal and acceptance, although the method of concluding an offer on the regulated market is more or less similar to each of these methods. Without going into detailed solutions, it should be indicated that concluding the agreement on regulated market is made through netting, i.e. through compensation. If each party to the transaction (an investment company) makes a buy (or sell) offer for a specified financial instrument, then none of them makes a statement on the acceptance (or rejection) of the offer of the other party. As described above, the offers are matched through a special computer system. Sale contracts concluded on the stock exchange are performed through the agency of a special clearing house, such as KDPW S.A., for example. Currently, however, transactions on the Polish capital market are settled by a subsidiary of KDPW S.A. – KDPW_CCP S.A. Upon KDPW _CCP S.A. being notified about a transaction, it performs a settlement novation, which involves the clearing house acceding to the rights and obligations of the parties to the stock exchange transaction. The parties to the transaction acquire, in return, applicable rights and obligations towards the clearing house. As a result, instead of one legal relationship between two brokerage houses, two separate relationships are created, i.e. between the selling party's brokerage house and the clearing house, and between the buyer's brokerage house and the clearing house. Once the transac-

[23] This is a slight generalisation, as it is possible for another entity to keep a securities account, and yet another entity to keep a cash account servicing this security account.

[24] It seems that the word "orders" would better reflect the sense of this activity (although it also has some discrepancies concerning semantic connotations).

[25] See: K. Zacharzewski, *Prawo giełdowe [Stock Exchange Law]*, C.H. Beck, Warsaw 2010, p. 262.

[26] This priority means that the higher the price given in the buy order, the higher priority this order will have for its execution. Similarly, sell orders with lower price limits are of higher execution priority.

[27] The priority means that if several offers were made at the same price, the execution priority applies to the order that was made first.

tion has been settled it is cleared. The National Depository holding the depository accounts of the system participants (e.g. of investment companies) "sees" the amount of financial instruments assigned to each participant. As a rule[28], financial instruments should be transferred between deposit accounts of the particular system participants (investment companies) as a result of this transaction. Because, if an individual investor placed an order to buy a financial instrument with an investment company, then as a result of its performance, the financial instrument bought by this company should be re-classified from the deposit account of the investment company of the selling party into the deposit account of the investment company of the buyer. This process is referred to as clearing the transaction. Along with this reclassification, the transaction must be settled, i.e. the cash and non-cash performances resulting from the transactions concluded between the members of the depository and settlement system (e.g. between investment companies). Upon the settlement (KDPW_CCP S.A.) and the clearance (KDPW S.A.) of transactions between the investment companies of the selling and buying parties regarding specified financial instruments, the investment company representing the investor on the stock exchange performs further settlement and clearance operations with this investor. This means that the buyer's securities account is credited with the financial instruments acquired for it, while at the same time debiting its cash account, while the investment company of the selling party debits its securities account (decreases the amount of specified securities in the account) and credits the applicable amount to its cash account (cash account crediting). So, in terms of accounting, the settlement and clearing take place first at the level of the competent houses (KDPW_CCP S.A. and KDWP S.A.), and later, i.e. when the transaction is already settled and upon its clearance between the investment companies (parties to the sale contract on the particular financial instrument), the settlement and clearance takes place between the investment companies and their respective customers, i.e. the investors, who placed relevant orders[29]. Securities

[28] In some situations, such transfers are not possible, e.g. when an individual investor buys a financial instrument from an investment company keeping securities and cash accounts for it, located in the account of this investment company.

[29] The possibility of performing the settlement and clearance between an investment company and investor after the relevant settlement and clearance by the entitled entities is referred to as *delivery versus payment*.



are transferred at the moment of performing relevant entries on the securities account under a contract for the transfer of dematerialised securities. If establishing the rights to benefits from dematerialised securities took place on the date when the transaction should be settled in the depository for securities, or later, and these securities are still registered in the account of the selling party, then the benefits are transferred to the buyer at the moment of making the entry in its securities account.[30] Making an entry in the securities account under a contract is made upon registering the transfer of securities between the relevant deposit accounts.

In summary, the most abridged description of a trading process may be taken down to the six most important points:

1. investors placing (buy and sell) orders with their brokerage houses
2. brokerage houses placing brokerage orders in the system registering the organised trading
3. the system matching brokerage orders
4. information about a transaction being forwarded to KDPW_CCP S.A. and so-called clearing novation
5. KDPW S.A. clearing the transaction
6. the securities account of the customer being registered accordingly.

[30] If the acquisition of dematerialised securities occurred on the basis of a legal event causing the statutory transfer of these securities, an entry in the buyer's securities account is made upon its request.

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# CONSORTIUM AGREEMENT AS A PROHIBITED AGREEMENT RESTRICTING COMPETITION

## Introduction

As in many countries, under the Polish law two or more entities can enter into a consortium agreement. Especially the bidding consortium agreement is becoming more and more popular, as it allows them to jointly apply for a public procurement contract. The aim of concluding of a consortium agreement is joint performance of the project – so it is quite natural, that it leads to exclusion of the existence of competition between entities engaged in consortium. The essence of the consortium is the common pursuit of that public procurement contract, and not competition with each other. Therefore, potentially concluding of consortium agreement, in some cases, appears to be prohibited agreement, which has as its object or effect the prevention, restriction or other distortion of competition within the relevant market. The purpose of this paper is to determine the legal frame of consortium agreement, as well as to analyse the views on the judicature and doctrine on the matter whether concluding consortium agreement can be recognised, on the ground of competition law, as a prohibited bid rigging. The author also would like to present his own view on the matter above.



## Legal frame of a consortium agreement

To properly analyse the legal consequences of concluding a consortium agreement in order to pursue a public procurement contract it is important to determine, what actually is a 'consortium'.

Firstly, there is no legal definition of 'consortium' or 'consortium agreement' neither in the Polish Act of 29 January 2004 – Public Procurement Law[1], nor in any other Polish act of law. Consortium can be defined as an organizational form created by the entrepreneurs, by which they undertake to strive to achieve a joint economic aim[2]. Consortium itself does not have legal capacity[3], organizational structure or separate assets[4]. The lack of legal capacity effects in the legal proceedings involving consortium participants – the party of legal proceeding consists of all the members of the consortium agreement. The contractual tie between economic operators and a contracting entity is not between a consortium itself, but between all the members of the consortium agreement and the contractor. In fact, Art. 23 sec. 1 of PPL states only that 'economic operators may jointly apply for a contract'. Provisions of PPL does not provide any indication of a legal frame of joint application for a public procurement contract – neither provides any reference to such term as 'consortium'. In spite of this, in practice economic operators conclude bidding consortium agreement in order to apply for a public procurement contract. One can say that traditionally a situation in which two or more entities jointly apply for a public procurement contract is known as a consortium[5].

It has to be considered, that consortium is an obligation relationship between the parties of a consortium agreement[6] (they are also called, maybe in misleading way, 'members of consortium' – it was

[1] Act of 29 January 2004 – Public Procurement Law (Dz.U.2015.2164 with amendments), hereinafter called as 'PPL'.

[2] M. Sieradzka, *Zmowy przetargowe w świetle zamówień publicznych oraz prawa konkurencji*, Warsaw 2015, p. 82.

[3] Decision of Supreme Court of 27 May 2010, III CZP 25/10, Legalis 223281.

[4] M. Sieradzka, *Zmowy...*, p. 82; resolution of National Chamber of Appeal of 22 July 2011, KIO/KU 54/11, Legalis 758918.

[5] Judgment of Regional Court in Szczecin of 16 April 2013, VIII Ga 78/13. Retrieved June 15, 2016 from: http://orzeczenia.szczecin.so.gov.pl.

[6] Resolution of National Chamber of Appeal of 22 July 2011, KIO/KU 54/11, Legalis 758918.

said before, that consortium is not separate legal entity). The consortium agreement is, in certain aspects, similar to a contract of civil law partnership (Art. 860 of Polish Civil Code[7]). According to this Article of CC, 'by the contract of civil law partnership the partners undertake to strive to achieve a joint economic aim by acting in a specified manner, in particular, by making contributions'. It has to be noticed that as a principle parties of consortium agreement does not make any contributions, so the consortium does not lead to creation of partners' joint property (differently – Art. 863 of CC). Therefore, the consortium agreement is not a simple contract of civil law partnership[8]. The consortium agreement, according to accurate view, is an innominate contract of civil law, to which the provisions of Civil Code regarding the civil law partnership shall be applied *mutatis mutandis*[9]. Only if the certain construction features of a civil law partnership are fulfilled, the consortium can be qualified as a civil law partnership[10].

## Consortium agreement from competition law point of view

As it was said already, conclusion of a bidding consortium agreement in order to pursue a public procurement contract is generally allowed – on the basis of Art. 23 sec. 1 of PPL. It should be noted, however, that the abovementioned rule of PPL does not exclude the application of competition law rules[11]. Thus, it is stated, in certain cases concluding a consortium agreement can be a breach of Art. 6 § 1 point 7 of Competition and Consumer Protection Act[12]. This provision states that any agreements which have as their object or effect the prevention, restriction or other distortion of competition within the relevant market shall be prohibited, in particular those which [...] fix the terms and conditions of bids proposed by undertakings entering a tender, or by those undertakings and the undertaking that organises a tender, including, in particular, the scope of works or price (bid rigging).

It has to be noticed, that in the doctrine of public procurement law, joint application for the public procurement contract is regarded as a mechanism generating positive impact on the competition in the process of awarding a public procurement contract[13]. It is stated that this mechanism promotes equal opportunities for small and medium entrepreneurs in competition with big market players, who have, independently, bigger resources[14].

Unfortunately, there is only single one decision of President of the Office of Competition and Consumer Protection, in which the antitrust assessment of concluding a consortium agreement was conducted (decision of President of the Office of Competition and Consumer Protection of 31 December 2012, RLU-38/2012). In this particular case, President of the Office regarded concluding a bidding consortium agreement between two undertakings, acting on a market of urban waste collection, as a restriction of competition on the local market of collection and transport of urban waste, thus – as action violating the

[7] Act of 23 April 1964 – Civil code (Dz.U.2016.380 with further amendments), hereinafter called as 'CC'.

[8] J.A. Strzępka, *Konsorcjum budowlane – wybrane zagadnienia prawne*, MoP 14/2012, p. 738–739; Judgment of Appelate Court in Szczecin of 28 May 2015, I ACa 29/15, Legalis 1327395.

[9] Ibidem.

[10] Judgment of Supreme Court of 9 July 2015, I CSK 353/14, Legalis 1303686; decision of Supreme Court of 6 March 2015, III CZP 113/14, Legalis 1186742.

[11] K. Kohutek in: K. Kohutek, M. Sieradzka, *Ustawa o ochronie konkurencji i konsumentów. Komentarz; Komentarz do art. 6*, electronic access: LEX 2014; G. Materna, *Zakres podmiotowy zakazu zmów przetargowych w polskim prawie ochrony konkurencji i prawie karnym*, "Przegląd Ustawodawstwa Gospodarczego" 2013/12, p. 6; G. Materna, *Zmowy przetargowe – granice i formy kooperacji w świetle aktualnej praktyki stosowania prawa ochrony konkurencji*, "Przegląd Ustawodawstwa Gospodarczego" 2015/10, p. 18–20; M. Salitra, *Jeśli nie możesz ich pokonać, dołącz do nich zgodnie z prawem – konsorcjum przetargowe w świetle ustawy o ochronie konkurencji i konsumentów*, "Internetowy Kwartalnik Antymonopolowy i Regulacyjny" 2015/8(4), p. 54; A. Zawłocka-Turno, *Zmowa przetargowa czy działanie zgodne z prawem? Problemy na styku prawa konkurencji i prawa zamówień publicznych*, "Internetowy Kwartalnik Antymonopolowy i Regulacyjny" 2012/4(1), p. 46.

[12] Act of 16 February 2007 – Competition and Consumer Protection Act (Dz.U.2015.184 with further amendments), hereinafter called as 'CCPA'; some authors view is that concluding consortium agreement is not a breach of Art. 6 § 1 point 7 CCPA, because this provision requires at least two bids to be fixed, while concluding consortium agreement is in fact agreeing one, joint bid: M. Salitra, *Jeśli nie możesz...*, p. 58.

[13] K. Horubski, T. Kocowski, *Konsorcjum jako instrument wsparcia małych i średnich przedsiębiorców w systemie zamówień publicznych*, [in:] J. Niczyporuk, J. Sadowy, M. Urbanek (ed.), *Nowe podejście do zamówień publicznych – zamówienia publiczne jako instrument zwiększenia innowacyjności i zrównoważonego rozwoju. Doświadczenia polskie i zagraniczne*, Warsaw 2011, p. 45–58.

[14] Ibidem.

ban indicated in Art. 6 § 1 point 7 of CCPA. President of the Office presented there a view that a possibility of concluding by two or more undertakings bidding consortium agreement is not uninhibited – however it is not stated *expressis verbis* in Art. 23 sec. 1 of PPL, its *ratio legis* is to enable undertakings, who are not able to perform a public procurement contract on their own, to pursue this contract. Substantial danger associated with consortia is the possibility of reduction of competition between undertakings, who, instead of presenting separate, competitive offers, eliminate competition between them, presenting one joint offer. As it is stated in the justification of this decision, there can be potentially two advantages of creating a consortium for the relevant market:

1. a consortium can enable a group of undertakings to take up tasks that exceed the capabilities of each of them individually; this situation can be particularly beneficial to the relevant market if it allows a group of smaller undertakings to compete with bigger undertakings, who have not been yet subject to a competitive pressure, but also cooperation between big market players can be beneficial to their contractors, eg. if it provides support of large orders, which none of the undertakings would be able to perform independently – in such cases consortium cannot be regarded asanti-competitive;
2. a consortium can lead to a connection of complementary assets, when all the assets are not possessed by each one of the members of the consortium; of course, each undertakings can buy/rent missing assets, but the connection of complementary assets can effect in performing the public procurement contract at lower cost than cost, which shall be incurred, if each undertaking performed the contract separately – in such cases even if conclusion of a bidding consortium agreement eliminates competition between its parties, the benefits for the contractors of the consortium (such as lower costs or better quality) at least compensates losses connected with less competition.

Furthermore, President of the Office presents a view, that consortium's positive influence on a relevant market will be the bigger:

1. the smaller would be a possibility, that its members would accomplish public procurement separately and



2. the bigger would be complementarity between their resources and the bigger would be cost of gaining these resources from the third parties.

What is more, the possibility of breach of antitrust law would be the bigger, the bigger market shares would be possessed by the parties of bidding consortium agreement. President of the Office sees concluding a consortium agreement as a prohibited agreement restricting competition because of its object, not its effect.

In fact, entire decision of President of the Office of Competition and Consumer Protection of 31 December 2012, RLU-38/2012 was revoked by the Court of Competition and Consumer Protection[15]. In the opinion of the Court, an agreement to present a joint bid in the tender did not violate the provision of Art.6 § 1 point 7 of CCPA. Only those agreements, which are concluded by undertakings entering a tender separately, can be regarded as prohibited in the understanding of the antitrust law. The condition for the admissibility of the consortium is that members of consortium came up with a joint offer, and not only agreed on the conditions of their separate bids. The cooperation between undertakings, both competing with each other, as well as those who act at various turnover levels, is one of the pillars of a functioning market economy. Such cooperation requires entering into such agreements, most of which produces pro-competitive effects or, at least, are neutral from the point of view of competition in the relevant market. M. Sieradzka regards present judgment is a milestone of antitrust judicature in the field of bidding agreements[16].

There are also many interesting views on the matter above in the doctrine of competition law. As states A. Zawlocka-Turno[17], if the consortium members are competitors, the result is usually a restriction of competition, since concluding consortium agreement reduces the number of potential bidders (so called 'reduced competition effect'), which promotes less aggressive bidding. Furthermore,

[15] Judgment of Court of Competition and Consumer Protection of 19 February 2015, XVII AmA 73/13, Legalis 1315629.

[16] M. Sieradzka, *Istnienie ekonomicznego uzasadnienia zawarcia umowy konsorcjum wyłącza jego antykonkurencyjny charakter. Glosa do wyroku SOKiK z dnia 10 marca 2015 r. XVII AmA 73/13*, "Internetowy Kwartalnik Antymonopolowy i Regulacyjny" 2015/5(4), p. 113.

[17] A. Zawłocka-Turno, *Zmowa przetargowa...*, p. 46–50.

according to her, when a consortium agreement is concluded without any objective justification, if the consortium members could submit offers separately, with a real chance of winning, it can be regarded as restriction of competition. In this author's opinion, concluding a consortium agreement as a prohibited agreement restricting competition because of its object or its effect. Concluding of a consortium agreement can be regarded as excluded from the ban of concluding agreements restricting competition, if it effects in increasing of efficiency of its participants – which can be assessed using the provision of Art. 8 sec. 1 of CCPA. A Zawłocka-Turno, aptly, draws attention to other aspects of concluding consortium agreement – a possible exchange of certain sensitive business information between potential consortium members.

J. Wiak[18], without any further explanation states that a cooperation of economic operators, who jointly apply for a contract, has to be result of inability to effectively submit a bid by a single economic operator.

D. Miąsik[19] does not analyse prerequisites, which have to be met to assess consortium agreement as prohibited. He states only that in certain cases one can apply to such agreements Art. 7 sec. 1 of previous Competition and Consumer Protection Act[20] (exemptions from the prohibition of agreements restricting competition – present Art. 8 of CCPA). According to this author, exemption can only be applied if members of consortium would not be able to bid separately – because of lack of proper capital, lack of proper warranties or too wide scope of works. The condition for the application of the exemption is that the members of consortium came up with a joint offer.

G. Materna[21] criticizes both decision of President of the Office of Competition and Consumer Protection of 31 December 2012, RLU-38/2012 and the judgment of Court of Competition and Consumer Protection, which revoked this decision. Firstly, he says, bidding consortium agreements have to be evaluated from the antitrust

[18] J. Wiak, *Spełnienie warunków udziału w postępowaniu przez wykonawców wspólnie ubiegających się o udzielnie zamówienia publicznego*, Warsaw, "Finanse Komunalne" 6/2012, p. 6.

[19] D. Miąsik, *Reguła rozsądku w prawie antymonopolowym*, Cracow 2004, p. 498.

[20] Act of 15 December 2000 – Competition and Consumer Protection Act (Dz.U.2005. 244.2080 with amendments).

[21] G. Materna, *Zmowy*..., p. 19–20.



law point of view. Secondly, to recognise consortium as prohibited, it has to be proved, that its creation causes anti-competitive effects, which complies with the EU law approach. EU law recognises *numerus clauses* catalogue of agreements restricting competition only because of its object. Only in specific cases (if joint bidding is only a tool serving to hide cartel agreement; if consortium is only a mechanism serving to reduce uncertainty as to obtain a public procurement contract, which specific parts are to be performed separately by each member of consortium) one can recognise consortium agreement as a prohibited agreement restricting competition because of its object.

M. Sieradzka claims, that if there is a lack of prerequisite of necessity, while concluding a consortium agreement, for the realisation of the purpose of this agreement, such agreement is prohibited by antitrust law[22]. In her opinion, a key issue in the antitrust assessment of consortium agreement is its effect, which has to be recognised as an influence on relations between members of consortium, the interest of contractor and interests of other market participants. She also, aptly, draws attention to the fact, that sometimes some part of potential of each economic operator is used in performance of other contracts[23] – it is impossible to demand from the economic operator to focus only on one public procurement contract and engage there all of his resources. But the most significant statement of this author is that the existence of economic justification for submitting joint offer excludes anti-competitive character of consortium agreement[24]. This last view of M. Sieradzka is also supported by M. Salitra[25].

In my opinion, there is no justification for regarding consortium agreement as admissible on the ground of Art. 6 § 1 point 7 of CCPA only when there is no objective possibility of taking part in tender by its members separately. I fully support M. Sieradzka's view that the existence of economic justification for submitting joint offer excludes anti-competitive character of a bidding consortium agreement.

[22] M. Sieradzka, *Istnienie ekonomicznego*..., p. 118–119.

[23] M. Sieradzka, *Zmowy przetargowe*..., p. 94–95.

[24] M. Sieradzka, *Istnienie ekonomicznego*..., p. 119.

[25] M. Salitra, *Jeśli nie możesz*..., p. 58.

## Legal effects of considering consortium agreement as restricted anti-competitive agreement

If an agreement is regarded as restricted anti-competitive agreement, it is null and void[26] in its entirety or in the respective part (Art. 6 sec. 2 of CCPA). Mentioned provision provides a civil law sanction[27]. In case of concluding consortium agreement, whole agreement is null and void (because the purpose and justification of its conclusion is restricted – not only its specific parts). Invalidity is effective *ab initio, ipso iure* and *erga omnes*[28].

If the consortium agreement is null and void, an organizer or a participant of a tender may demand cancellation of the public procurement contract on the ground of Art. $70^5$ of CC[29]. The above-mentioned entitlement shall expire upon the lapse of a month from the day when the person entitled learned about the existence of a reason for invalidation, however no later than upon the lapse of a year from the day when the public procurement contract was concluded.

[26] A. Piszcz in: T. Skoczny (ed.), *Ustawa o ochronie konkurencji i konsumentów. Komentarz*, Warsaw 2014, p. 305.
[27] Ibidem, p. 304.
[28] Ibidem, p. 307–208.
[29] J. Wiak, *Spełnienie warunków...*, p. 6.

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# THE ZONE OF INSOLVENCY IN THE CZECH LEGAL SYSTEM: A COMPARATIVE ANALYSIS

## Introduction

There is a general understanding that the objectives of corporate governance in the United States and Europe are fundamentally different[1]. The corporate law of the United States[2] is known for its strong support of the "shareholder supremacy model" in which, generally speaking, shareholders' interests are given the priority in governing corporate affairs[3]. On the other hand a number of countries in Europe, most notably Germany, and their corporate law systems are said to be following a different model that takes into consideration not only the interests of shareholders but also the interests of other parties that have stakes in the company[4]. This is often referred to as the "stakeholder model" of corporate law[5].

Until recently the corporate law system of the Czech Republic could have been considered as an example of the stakeholder model as many traits attributable to this standard were an integral part of the

[1] See e.g. Th. Baums, *Taking Shareholder Protection Seriously?* Corporate Governance in the United States and Germany, 53 Am. J. Comp. L. 31 2005.
[2] Whenever this text mentions the corporate law or corporate governance system of the United States it is referring to the rules and legal framework of Delaware as the most prominent jurisdiction within the U.S.
[3] A. Keay, *The corporate objective 40* (Edward Elgar Publishing 2011).
[4] Id. 114.
[5] R. Kraakman et al., *The anatomy of corporate law: a comparative and functional approach 61* (Oxford University Press 2004).

legal system[6]. However, as a part of the 2014 private law recodification process the Czech corporate law framework has adopted corporate governance mechanisms and concepts that have originally been developed by the Anglo-American jurisdictions. Naturally, the system of corporate governance rapidly changed.

This paper first briefly introduces the history behind the Czech recodification process, describes the state of corporate law before 2014 and explains the reasons and motivation that led to the fundamental changes in the Czech legal system. This paper then moves on to discuss the issue of zone of insolvency and directors' duties. It describes the agency problems that arise in such situations and examines two opposite approaches that German and American legal systems developed to tackle the issue. In the end this paper analyzes Section 62 of the Czech Business Corporation act which represents the new Czech legislative solution to the problem of directors' duties in the zone of insolvency.

## Corporate law system of the Czech Republic and its recent changes

The legal system of the Czech Republic has been historically influenced by major European jurisdictions, most notably by neighboring Germany[7]. Therefore it should come as no surprise that certain features of the stakeholder model pursued by German company law were applied by the Czech corporate law system as well.[8] Never the less, the Czech Republic got an opportunity to reconsider its corporate governance approach within the long awaited process of recodification.

The recodification process was to bring new modern legislations in the area of private law that would replace the framework that the Czech Republic created shortly after the fall of communism in 1989. As a result of the sudden political, social and economical changes new

[6] H. Hansmann, R. Kraakman, *The End of History for Corporate Law 89*, "Georgetown Law Journal" 439, 444–446 2001.

[7] Explanatory Memorandum to the Business Corporation Act (Parliament of the Czech Republic 2012), p. 1.

[8] Most notably the statutory requirement of employee representatives on supervisory boards, also known as "codetermination".



government did not have enough time or resources to form adequate legislations. As such only absolutely necessary modifications were made to the legal framework with the notion that new laws would be enacted over time. However, in the area of business organizations the ultimate change did not occur until recently.

In 2014 a set of new acts of the Czech Parliament came into effect in the Czech legal system. Beside the most prominent act in the form a new Civil Code, the Business Corporations Act[9] (further also referred to as "the BCA") was one of the core outcomes of the recodification process that was to shape the legal system into a modern and attractive regulatory framework[10].

In terms of corporate governance, the Business Corporations Act openly acknowledged that it found a lot of inspiration in the Anglo-Saxon model[11]. As such the BCA implemented a number of features that are typical for the common law jurisdictions pursuing the shareholder supremacy, most notably the United States. These new features of Czech corporate governance system include concepts of fiduciary duties, business judgment rule, one-tier board, detailed regulation of conflicted transactions or executive compensation[12]. At the same time, the new corporate regulation eliminated a number of features associated with the stakeholder model, most notably mandatory involvement of employee representatives in corporate management (codetermination). As a consequence, the process of forming new corporate framework gave the corporate governance objective a new direction which puts the interests of shareholders at the forefront of Czech corporations.

This seemingly theoretical reality has a great practical impact, especially in situations where interests of the company and its shareholders are in a direct conflict with other parties and constituencies[13]. Corporate law systems pursuing a stakeholder model are likely to solve

[9] Zákon č. 90/2012 Sb. (Czech).

[10] Explanatory memorandum, supra note 7, p. 2.

[11] Id. at 23.

[12] It is not the objective of this Article to describe how these individual concepts help shift the system towards the shareholder supremacy. However, the author believes that this is precisely the effect that the new legislations brought about.

[13] Laura Lin, Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Director's Duty to Creditors 46 Vand. L. Rev. 1485, 1486, 1993.

these tensions by finding a compromise between the conflicting parties[14]. On the other hand, shareholder supremacy jurisdictions in similar situations are not concerned about anything else but the interests of the corporation and the shareholders[15].

Next chapter introduces the topic of nearly insolvent corporations and demonstrates the fundamental conflict between the shareholders and their directors on one side and creditors on the other. As the conflict of interests in the zone of insolvency essentially boils down to risk preferences, next chapter begins with unraveling the economic considerations of individual parties.

## Risk and the Zone of Insolvency

It is impossible to draw a generalization as to whether directors are risk lovers or risk averse in respect to the corporate decisions. Whichever the case might be, it is important to note that directors do not have to be too concerned about the element of risk embedded in their decisions as long as they meet other applicable standards. The safe harbor of business judgment rule provides that directors will not be held liable as long as they become reasonably informed about relevant facts and their decision is not conflicted. As such, the court only scrutinizes their duty of care and duty of loyalty – the level of risk associated with a particular project or a decision is not a subject to a judicial test.

In general, creditors and their risk preferences receive little protection or consideration by virtue of corporate law[16] or directors' fiduciary duties. This is because, theoretically speaking, there is no need for it. In a financially healthy corporation with no concerns about company's solvency creditor's interests are not in conflict with those of

[14] See: C. Blanaid, *The EU Takeovers Directive: a shareholder or stakeholder model?*, [in:] *The embedded firm corporate governance, labor, and finance capitalism*, ed. P. Zumbarsen, Cambridge 2011, p. 233–255, for discussion regarding European regulation of takeovers as another example of situations in which corporate constituencies are in a severe conflict of interests.

[15] See below In re N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007).

[16] Exceptions include rules on distribution of capital, the concept of piercing a corporate veil or equitable subordination. See W.T. Allen et al., *Cases and commentaries on the law of business organizations 115*, Wolters Kluwer, 4th ed. 2013.



shareholders. In other words, as long as the assets far exceed the liabilities creditors do not need be concerned[17].

However, things rapidly change when corporation's financial health worsens and it starts operating in a zone of insolvency. In these circumstances assets of a corporation diminish and their value approaches the level of liabilities[18]. At this point, the interests of creditors are likely to be adverse to any business strategy carrying essentially any amount of risk as any unsuccessfully implemented decision or operation increases the possibility of insolvency which threatens the creditors' return on invested capital. Consequently, it is in the best interest of the creditors that the company engages only in operations that carry only minimum or no risk at all[19].

A significant shift in risk preferences, however, may occur on part of the shareholders as well. While shareholders might be both risk averse and risk lovers in the times of company's financial health it is likely that their preferences in risky operations increase as insolvency looms. This is because, simply speaking, they lose little when a risky decision does not turn out well, but enjoy the upside when it does. Consequently, high risk preferences are likely to emerge on part of shareholders when a company finds itself in the zone of insolvency[20]. This is an important observation as directors may, under the underlying principle of shareholder supremacy jurisdictions (maximizing shareholders' profit), translate these preferences into their decisions[21].

To illustrate the conclusions of the preceding paragraphs let us examine following example:

Company OMEGA has $100.000 in assets, $99.000 in liabilities and future cash flow that allows the company to pay its debts as they fall due and payable; however OMEGA makes little or no profit on its operations. OMEGA is not yet insolvent but is very sensitive to

[17] Id., at 270.

[18] This fairly vague definition of zone of insolvency will be used throughout the article.

[19] L. Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Director's Duty to Creditors*, 1993, 46 Vand. L. Rev. 1485, 1486.

[20] Id. at 1487.

[21] This conclusion goes to both closely and dispersedly held corporations, although it is likely that this effect would be much higher in closely held corporations where interaction between the directors and shareholders is common. Naturally, in corporations with a controlling shareholder the assumption becomes a certain reality.

any disruption in its operations (OMEGA is in the zone of insolvency). To improve its financial stability OMEGA seeks new projects and now has two mutually exclusive options to choose from. Under Project A the company has 20% chances to increase its value to $200.000 and 80% chance to fall to $10.000 in value. The expected value of the project A is *negative* $52.000[22]. Under Project B there is 95% chance that the company will be worth $105.000 and only 5% chance that the company value will decrease by $1.000. The expected value of Project 2 is *positive* $4700[23].

Although the Project B has a higher (and more importantly positive) expected value it may not be too appealing to OMEGA shareholders. To the contrary, they might be motivated by the upside of project A which may yield up to $100.000 and carries the risk of effective loss of only $1000[24].

Under given financial circumstances, Project A is, however the worst possible option from the perspective of the creditors. While they do not receive any upside whatsoever with any of the projects[25], they face a massive downside with Project A[26]. Therefore, if any, creditors would much rather see Project B being implemented.

Divergence in interests of such a magnitude gives the corporate law an opportunity to regulate the duties of directors as it sees fit. To see how traditional shareholder supremacy jurisdictions deal with these situations, this article next illustrates the solution under Delaware corporate law. After this, the article moves to the Czech legal system to examine whether the Business Corporation Act adopted similar solution. If this is the case, it would be yet another evidence of corporate governance shift towards the shareholder supremacy model.

[22] Project A itself has a 20% chance to make $100.000 and there is 80% chance that the project will result in a loss of $90.000. Therefore the expected value is calculated as follows (100.0000*0.2) + [(-90.000)*0.8].

[23] 95% chance to make $5.000 and there is 5% chance that the project will result in a loss of $1.000. Therefore the expected value is calculated as follows (5.000*0.95) + [(-1.000)*0.05].

[24] Economically speaking, any losses below $99.000 are incurred on part of the creditors, rather than shareholders.

[25] Creditors' stakes are fixed and they have no interest in the profits of the corporation.

[26] The creditors suffer from any decrease of the assets they lose potential source of proceeds that may cover their stake in the event of liquidation.



## Directors' duties and the zone of Insolvency in Delaware (USA)

It is well established in the United States that fiduciary duties are owed to the corporation[27]. The interest of a corporation is therefore the primary factor that should be taken into consideration when making decisions about corporate affairs. Of course, since the corporation is itself a fictional character it cannot police or enforce these duties. Corporate law then needs to make a decision as to who will be given the enforcement rights on behalf of the corporation and thus effectively be given a great amount of influence on corporate affairs.

Corporate law in the U.S recognizes that shareholders are best situated to police and safeguard the value of a corporation. This is because the shareholders' claims are subordinated to any other claims against corporation and thus they have the incentives to enforce efficient decision making that leads to a highest possible residual claim effectively enhancing corporate value[28]. As such it is often simplified that directors owe duties to shareholders, rather than the corporation[29].

This rationale is no longer viable once the corporation becomes insolvent. There is no point in giving the shareholders the policing and enforcement rights because they no longer have a stake in the corporation. They have no incentive to monitor and enforce reasonable governance of the corporation if they do not receive any reward. This is the reason why the rights of enforcement must be assigned to a different constituency which still has sufficient incentives to police and monitor. Not surprisingly, it is the creditors who are granted these rights when a company becomes insolvent as they still have stakes in the corporation, particularly its remaining assets[30].

As for the enforcement and monitoring rights somewhat unclear situation had been present in Delaware corporate law in cases where a company operated in the zone of insolvency. The Delaware courts implicitly suggested in *Credit Lyonnais Bank Nederland v. Pathe Communications Corp.*[31] that fiduciary duties of nearly insolvent corporations may in fact be owed to creditors rather than shareholders. Under

[27] W.T. Allen, supra note 15, at 270.

[28] Id.

[29] Id.

[30] The law of bankruptcy of all jurisdictions is build on this preposition.

[31] WL 277613 (Del. Ch. 1991).

this theory, creditors would be given a cause of action against the directors even though it was not yet confirmed that assets of the corporation would not satisfy creditors' claims. Inevitably, this approach would lead to a scheme under which directors did not even know to whom their fiduciary duties were owed. In other words, directors could not be sure whether their decisions could be challenged by the creditors, the shareholders or both[32].

The issue of utmost uncertainty was resolved by the Delaware Supreme Court in 2007. The Court clarified its earlier findings on the matter and stated that creditors may never bring a lawsuit, direct or derivate, against the directors of companies that are in the "zone of insolvency"[33]. The court opined: "*When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners*". It is therefore now established by the case law that the creditors have no right of enforcement when it comes to fiduciary duties of directors that navigate a corporation in the zone of insolvency.

The strategy that the Delaware corporate law implements when a conflict of interest arises between the shareholders and creditors is that no special consideration to the needs and interest of creditors is given. Despite the fact that there were options of helping the creditors protect their interest[34] Delaware corporate law decided not to do so. Thus, the zone of insolvency does not change anything in the governance of the company and the directors continue to discharge their duties to the corporation and the shareholders. This solution clearly confirms the shareholder's supremacy model of corporate governance under Delaware law.

[32] For further discussions of the court's ruling see R.B. Campbell Jr and Ch.W. Frost, *Managers' Fiduciary Duties in Financially Distressed Corporations. Chaos in Delaware (and Elsewhere)* 32 J. Corp. L 491, 2007; R.M. Cieri and M.J. Riela, *Protecting Directors and Officers of Corporations That Are Insolvent or In the Zone or Vicinity of Insolvency: Important Considerations*, Practical Solutions 2 DePaul Bus. & Com. L.J. 295, 2004.

[33] N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007).

[34] By granting them the right to enforce directors' fiduciary duties owed to the corporation as the plaintiff in Gheewalla argued.



## The zone of Insolvency in Germany

In the preceding section it has been shown that in Delaware directors do not owe any fiduciary duties to the creditors – rather, even in the zone of insolvency, they shall pursue the interests of its shareholders and the corporation. German corporate law is quite different in this regard. Instead of encouraging directors to do their best to save the corporation it maintains that the directors shall file for bankruptcy proceedings as soon as the company becomes endangered by insolvency and holds the directors personally liable if they do not do so[35].

In general, when a German company gets into financial difficulties, the directors may (and should) become concerned about the legal concept of *Insolverschleppungshaftung* – liability for delayed filing for insolvency. Under this concept a director is essentially personally liable directly to creditors in delict for untimely filing and thus motivated to file for insolvency proceedings rather sooner than later[36].

By creating this strict mechanism directors in Germany have significantly less discretion regarding solutions to company's distressed situation[37]. This may be perceived as a very strong protection of creditors' interests who would typically be opposed to company's desperate attempts for a turnaround which may often eventually destroy remaining company value leaving creditors with empty hands. This solution especially resonates when compared to the Delaware approach where directors are legally required to pursue the turnaround and are not liable for the delay in filing for insolvency (deepening insolvency)[38].

## The zone of insolvency in the Czech Republic

The legal system of the Czech Republic, being rooted in the civil law tradition, imposes rules on company directors primarily via statutes. In particular, Sections 62 of the Business Corporation Act is the

[35] T. Bachner, *Creditors protection in private companies, anglo-american perspectives for a european legal discourse 181*, Cambridge 2009.

[36] H. Sismangl, *Creditor-protection in private equity-backed leveraged buyout and recapitalization practice 166*, 2014.

[37] Id.

[38] See Trenwick America Litigation Trust v. Ernest & Young, L.L.P., 906 A.2d 168 (Del. Ch. Aug. 10, 2006).

primary source of guidelines for directors who are navigating a company through the zone of insolvency[39].

The core part of the provision states that the directors may be held personally liable (and thus found to breach their duties) provided that *they knew or should and could have known that the business corporation faces an imminent threat of bankruptcy [...] and, in breach of the duty of due care, failed to take all necessary and reasonably foreseeable steps to prevent the bankruptcy.*

In essence the above outlined provision requires the directors to do their best to find a solution to the financial difficulties the company found itself in *preventively* and *outside* the insolvency proceedings. Thus directors of companies in the zone of insolvency shall continue the business operation and pursue all possible opportunities that have the potential to turn things around. The mechanism thus looks a lot like the one maintained by the Delaware corporate law. The German, creditor friendly, approach of early filing for insolvency proceedings does not have any support within the Section 62.

Further, it is obvious that Section 62 does not alter shift directors' duties. In other words, even in the zone of insolvency, directors owe their duties to the corporation and to the shareholders. No language in this section or elsewhere in the Business Corporation Act suggests that the directors' general objective to maximize shareholders' welfare should be shifted in favor of the creditors. Since there is no such requirement it should be concluded that creditors do not have a direct claim against the directors even if their obligation set in Section 62 shall be found violated. In such a case, it is the corporation who has standing against the directors – not creditors themselves. It is true that in the event of bankruptcy creditors are the real owners of the corporation and thus shall be entitled to any residual claim, however it is the corporation who has standing in such a situation, not each and every creditor individually. Ultimately, it is the bankruptcy administrator who collects such damages on behalf of the corporation. Any process would be then distributed among the creditors *pari passu*.

[39] Formally these provisions set forth the conditions under which directors may be held personally liable and forms of liability that the court may impose under the new Czech corporate law system. Materially, however they outline requirements that the law cast on directors' actions regarding nearly insolvent corporations.



The fact that directors do not owe fiduciary duties to the creditors in the zone of insolvency suggests that directors have full discretion over company business and operations. Going back to the demonstration of the conflict of interests among the corporation (and its shareholders) and the creditors,[40] which suggests that shareholders would like to see risky but potentially high rewarding project when the company is on the brink of insolvency, the implication may be that directors are not in fact bound by any restrictions as far as risk taking as no such limit is specifically mentioned in Section 62[41].

The fact that Section 62 does not explicitly say that directors should be particularly cautious as far as risk taking may be a meaningless notion. After all, the fact that a legal provision does not say something is forbidden does not necessarily mean that it is allowed[42]. However, the lack of risk regulation where it may be potentially appropriate is particularly interesting if we realize that the Civil Code, a direct complement of the Business Corporation Act in fact addresses the issue of risk in some situations. In particular, Section 1432 of the Civil Code states that *"[a]n [trust] administrator decides on investments taking into account their yield and expected profit"*[43]. It could be argued therefore that for example subjecting the investment decisions of distressed companies to the investment rules concerning a trust administrator would have been a sensitive solution had the Business Corporation Act wanted to limit directors' risk taking under the stakeholder approach. Under this solution directors would have been provided with statutory guidelines on the required conduct, while creditors would not have to be concerned about the "go big or go bust" kind of decisions. Nevertheless, the legislation has not embraced this approach which may suggest that directors maintain their wide discretion regarding risk even at times of distress just like they do when the times are good[44].

[40] See Section 3 of this Article.

[41] Despite the fact that the downside would be born by the creditors. For details see Section 3.

[42] Further legal analysis would have to be applied.

[43] Regardless of the improper language it is obvious that the provision requires the administrator to be cautious when it comes to investments and their risks.

[44] It should be noted that Section 62 does maintain that directors should in essence "take all necessary and reasonably foreseeable steps to prevent the bankruptcy". The counterargument therefore would be that this wording in fact includes cautiousness in respect to business risk taking.

## Conclusion

The Czech Republic has made a significant change in its corporate governance system. However, a number of important issues remain unresolved at the moment. While it seems obvious that the zone of insolvency approach of the Business Corporation Act is leaning more towards the Anglo-American solution, which requires directors to actively deal with the troubled financial situation of the company, it remains unclear what the implications for opportunistic risk taking are.

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# UKRAINIAN LIMITED LIABILITY COMPANY – SOME ASPECTS OF LEGAL REGULATION

## Introduction

A limited liability company is the most popular type of entrepreneurship throughout the European states, because of its universality and flexibility. However, the meaning of a limited liability company in Ukraine is even wider. Official statistics should be presented. According to the data of the Ukrainian unified register of enterprises, organizations and sole traders nearly 520 228 companies are registered[1]. That is more than 93% of all commercial legal entities (in comparison: in Poland by 01.01.2016 345 135 limited liability companies were registered that is 83% out of the whole number of business organizations (413 813 commercial companies (*spółek handlowych*)[2] in Poland). This fact shows how significant the role of this type of commercial companies is in Ukraine. The dynamics of the last years just confirms this fact. A limited liability company is the most popular type of legal persons for the new formed enterprises[3]. However, a Ukrainian legislator still does not pay enough attention to make its regulation more perfect.

A lot of work was done in the field of business registration during the last years. The reduction of minimal capital, shortening of the time

[1] "Perevagy ta nedoliky organizaciyno-pravovych form tovarystv v Ukraini". Retrieved June 15, 2016 from: http://jurliga.ligazakon.ua/news/2014/4/23/109462.htm.

[2] Annual report "Structural dimensions in the state's economy" Polish National register, 01.01.2016 r., Warszawa 2016, p. 31, 127.

[3] Earlier private enterprises (Приватне підприємство) were also popular. But today they haven't essential significance in the market.

for registration of business, the implementation of electronic registration are among the most visible measures that were taken by the last two governments. Due to these facts and some others Ukraine changed its position in the International rate (the states all over the world were taken into account) of business from 152-nd (in 2012) to 83-rd position (in 2016)[4].

But there are some facts that an investor should remember when coming into the Ukrainian capital market. The aim of this article is to show a few aspects of conducting business in a such legal form as a limited liability company.

## Foundation and incorporation of LLC

The legal status of a limited liability company is stipulated by the Law of Ukraine *On Commercial Companies*[5] (articles 50–64), the Civil Code of Ukraine[6] (articles 140–151), and the Commercial Code of Ukraine[7] (articles 79–92). The legal norms on commercial company are also applicable (articles 1–23 of the Law of Ukraine *On Commercial Companies* and 80–113 of the Civil Code of Ukraine). Nevertheless, legal regulation is characterized by wide dispositivity. The Ukrainian law proposes wide possibilities to regulate the corporate relations at the discretion of shareholders.

LLC's original name is "*tovarystvo z obmezhenoju vidpovidal'nist'u*". A limited liability company can be established by a natural person or legal entity and it can have one founder or more. The possibility of establishing a company by one founder has been implemented relatively recently. Earlier a minimal number of founders was three persons. However, the Commercial Code stipulates a restriction, basing on which a company with a single shareholder cannot be a single founder or a single shareholder of another company.

[4] Doing business 2016: measuring, regulatory quality and efficiency, Washington 2016, p. 5.

[5] Law of Ukraine "About commercial companies". Retrieved June 15, 2016 from: http://search.ligazakon.ua/l_doc2.nsf/link1/T157600.html.

[6] Civil Code of Ukraine. Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/435-15.

[7] Commercial Code of Ukraine. Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/436-15.



The articles of Association are used for the foundation and business activity of a limited liability company. They should be made in writing and signed by all shareholders. It is worth mentioning that their signatures should not be authenticated by notary act as it is in Poland[8], Slovakia[9] or the Czech Republic[10].

There is no minimum amount of the company's registered capital. By the way, Ukrainian legislation does not have division on contributions. Therefore, shareholder's contribution may be one euro or even less. In the author's opinion, these provisions rise the attractiveness of a limited liability company today (15 years ago the minimum registered capital was nearly 25 000 Euros). As in neighboring states at least 50% of each primary contribution into the company must be paid up before filling in the application for the company's registration in the Commercial Register.

## Shareholder's rights and duties

The basic rights of shareholders of a limited liability company include: 1) property rights (a right to share in profits; a right to settlement share; a right to share in liquidation balance): 2) other rights: rights related to the management of a company and the supervision over its operations; a right to information;

The duties of the shareholders of a limited liability company include: contributory obligation; obligation of additional contribution; liability for the obligations of the company;

A basic duty of a shareholder is contributory obligation. A shareholder is obliged to pay up his contribution under the conditions and within the terms set forth by law or in the articles of association. However, such a payment must be made within one year following

[8] *Kodeks spółek handlowych, stan prawny: 01.09.2013*, Warszawa, p. 37.

[9] A. Skrinar, Z. Nevolna, L. Kvokacka, *Fundamentals of Slovak Commercial Law*, Plzen 2009, p. 104.

[10] Zákon o obchodních společnostech a družstvech (zákon o obchodních korporacích). Retrieved June 15, 2016 from: http://www.zakonyprolidi.cz/cs/2012-90#cast1-hlava4.

the company's incorporation. At the same time Ukrainian legislation does not stipulate responsibility for failure of this duty.

Another important obligation of a shareholder of the limited liability company is the so-called obligation of additional contribution. The obligation of additional contribution consists in the obligation of a shareholder to make a contribution, pro rata to his pledged original contribution. But this obligation is only applicable when it is mentioned in the articles of association.

A sole shareholder is not entitled to take the following actions on behalf of the company: to make claims for damages or other claims that the company has towards an executive; to make claims for the payment of a contribution towards a shareholder who is delayed with the payment of his contribution, to make claims for the refund of payments provided to a shareholder contrary to law. It is due to the fact that indirect (derivative suit) is still under discussion in Ukraine.

Each shareholder, whose contribution reaches at least 20% of the registered capital, is entitled to request the convening of a general meeting. If the executives do not convene a general meeting in such a way as to take place within 25 days from the date of receiving such a request, the shareholders are authorized to convene it themselves.

## Bodies of a Limited Liability Company

The obligatory bodies are the general meeting and the executives. The company can also establish supervisory board or other bodies stipulated in the articles of association. Unlike a joint-stock company, supervisory board in a limited liability company is an optional body.

The general meeting is the supreme body of the company. The shareholders exert their rights related to the management of the company and supervision over its operations in the general meeting. The articles of association may not limit statutory competences. They can only extent the scope of competences. The general meeting constitutes a quorum[11] where shareholders in attendance constitute at least 60 % of all votes. The articles of association may regulate a quorum

[11] Quorum – some minimal quantity of share that shall be present on the general meeting to make it valid.



otherwise they cannot determine a lower number of votes required for a quorum than stipulated in the Law of Ukraine *On Commercial Companies*.

The executives are statutory body of the company. It means they act on behalf of the company outwards. Their competences also include the participation in the company's management in the issues that are not committed under competence of the general meeting by the Law of Ukraine *Commercial Companies* or the articles of association.

## Transfer and transition of a share

The transfer of a share (ownership interest) is the most frequent way of termination of a shareholder's participation in the company during its existence. In principle, a share can be transferred to a third party only if it is not prohibited in the articles of association. A shareholder of a limited liability company may cede his share (its part) to one or several shareholders of the same company or third persons. The shareholders have the preferential right to acquire the share (its part), proportionally to their shares in the registered capital of the company or to the amount agreed upon by and between them (the so-called preferential rights).

The transition of a share can also occur upon: 1) dissolution of a legal entity that is a shareholder of the company; 2) the death of a shareholder. Where a legal entity holding an ownership interest in a company is wound-up, its ownership interest is transferred to its legal successor. Ownership interest can be also inherited. However, the articles of association may forbid ownership interest to be transferred to a legal successor of a wound-up entity or to be inherited. The articles of association may not exclude the inheritance of ownership interest if it has the only shareholder.

An heir who is not the only shareholder may claim dissolution of his participation by the court, if he cannot be reasonably required to be a shareholder.

## Withdrawal of a shareholder's participation

The Law of Ukraine *On Commercial Companies* stipulates the various methods of termination of a shareholder's participation in a limited liability company such as: transfer of ownership interest, winding-up of legal entity that is a partner, the death of a partner, expulsion of a partner in the procedure of expulsion, execution on ownership interest.

The judicial statistics shows that the court refuses a shareholder's claim on expulsion in 99 % of cases. According to Ukrainian legislation the expulsion of a participant is exclusive competence of a general meeting.

The reasons of expulsion are the following: if a shareholder constantly fails to fulfill his commitments; if he unduly fulfils them; if his actions impede the company to achieve its goal.

The procedure is the following: such a person (who has done one of the above mentioned actions) should be withdrawn from the company on the basis of a decision voted through by the shareholders possessing in the aggregate over 50 per cent of all votes. The shareholder does not vote in this case and his votes are not taken into account.

In the author's opinion, this procedure is not very effective. First of all it is worth mentioning that it is rather difficult (sometimes even impossible) to expel the shareholder who has a majority or whose share is 50 % and more of the registered capital. The reason is because of high percentage for a quorum. According to the article 60 of the Law of Ukraine *On Commercial Companies* the quorum is 50 percent and one vote. That is one of the highest levels in Europe.

As a result the general meeting is in a stalemate. The shareholder, who should be expelled, does not visit the general meeting. As a consequence the general meeting is invalid and cannot make any decisions.

Besides the above mentioned fact some other measures are not stipulated in Ukrainian legislation. Calling the shareholder to fulfill his duties and warning him in writing of the possibility of expulsion is a norm in the legislation of many European states[12]. Moreover, the shareholders, whose contribution in the company represent not less than 50% of the registered capital, must agree with such a request.

[12] A. Skrinar, Z. Nevolna, L. Kvokacka, *Fundamentals of Slovak Commercial Law*, Plzen 2009, p. 104.



Therefore, on the one hand the company cannot struggle against a major shareholder (or whose share is significant). On the other hand, a minor shareholder has no guarantees that he will not be expelled from the company. To change such situation, in the author's opinion, the above mentioned measures should be implemented into Ukrainian legislation.

## Winding-up of a Limited Liability Company

Winding-up of a limited liability company is regulated both by the general provisions on winding-up of business companies and by the specific provisions governing winding-up of a limited liability company. In addition to the reasons for winding-up of a company as specified in the general provisions on winding-up and dissolution of business companies, the company can be also wound up according to the court decision made on the basis of a request by a shareholder or an executive for the reasons and under conditions stipulated in law or, as the case may be, in the articles of association. A limited liability company ceases to exist upon its deletion from the Commercial Register.

## Conclusions

A limited liability company is the most attractive form of investment for a small and medium investor while a joint stock company is the most suitable for large business. However, the investor should take into account its advantages and disadvantages.

The advantages are as follows: an easy registration; a small minimal registered capital on start; a dispositive method of legal regulation (a possibility of corporate relations' regulation at the discretion of the shareholders).

The disadvantages include the duplication of regulation by three legal acts (the Law of Ukraine *On Commercial Companies*, the Civil Code of Ukraine, the Commercial Code of Ukraine); a weaker protection of an investor in comparison with the legislations of European states; the absence of a shareholder's liability in case of failure to fulfill the obligation to pay a contribution.

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# SINGLE-MEMBER PRIVATE LIMITED LIABILITY COMPANY

## Introduction

The European Commission adopted on 9 of April 2014 a proposal for a Directive of the European Parliament and of the Council on a single-member private limited liability company[1]. As indicated in the explanatory memorandum, companies find it costly and difficult to be active across borders and only a small number of Small and Medium Enterprises (SMEs) invests abroad due to the diversity of national legislations, in particular differences in national company laws, and the lack of trust in foreign companies among customers and business partners. To overcome such obstacles, the European Commission aimed to address these costs in its 2008 proposal for a European Private Company Statute (SPE) as an instrument facilitating cross-border activities, which would be simple, flexible and uniform in all Member States. Yet, despite strong support from the business community it was not possible to find a compromise allowing for the unanimous adoption of the European Private Company Statute among Member States. The overall objective of the proposal on the single-member company, which provides an alternative approach to the SPE, is to make it easier for any potential company founder, and in particular for SMEs, to set-up companies abroad. It would facilitate cross-border activities, by providing in the Member States for a national company law form that would follow the same rules in all Member States and would have an EU-wide abbreviation – SUP (*Societas Unius Personae*).

[1] COM/2014/212 final, 2014/0120 (COD).



As the Polish legal system has allowed for the possibility of founding a single – member company for a long time, the aim of this article is to investigate to what extent the Polish regulation differs from the proposal for the Directive.

## The single-member company under Polish law

The Polish Commercial Companies Code[2] provides for the possibility of founding a single-member company in two forms, as a single-member private limited liability company and a single-member joint stock company. According to the definition given in art. 4 § 1 p. 3 CCC, the single-member company shall mean a company in which all the shares are held by one shareholder.

Notably, under Polish law the single-member company does not differ as regards the structure and requirements from a regular company (private limited liability company or joint stock company) apart from the fact that it has only one shareholder. It may be converted into a 'regular' company by way of sale of one or more shares in the company, then it will have more than one shareholder. Nevertheless, due to its characteristics the single-member company shall be governed by special provisions in the period of being single-member.

Owing to the fact that the proposal for the Directive relates specifically to private limited liability companies, this article discusses only this form of company.

According to art. 151 § 1 CCC, the private limited liability company may be established by one or more persons, for any legitimate purpose, unless the law provides otherwise. As for the founders of a single-member company, the provisions of the Act allow one exception, namely a single-member liability company may not be formed solely by another single-member liability company (art. 151 § 2 CCC). This restriction refers only to 'the founding period,' thus after the registration a single-member company may be a sole shareholder, if it buys all the shares[3]. The most important requirement to be fulfilled

[2] The Code of Commercial Partnerships and Companies of 15 September 2000, Journal of Laws, 2000.94.1037.

[3] In the literature, however, it is a matter of dispute whether a single-member compa-

by a single-member company is the obligation to disclose the fact of being single-member in the registry court, either at the time of registration or where one person buys all the shares after the registration. According to art. 166 § 2 CCC, the application for registration of a single-member company shall contain its full name or the business name, registered office and address of the sole shareholder, as well as the annotation that it is the sole shareholder of the company. This provision shall apply in the case of acquisition by one shareholder of all the shares in the company after its registration (art. 166 § 3 CCC).

With respect to the structure of the company, as mentioned above, there is no difference between a single-member and multi-shareholder company, nonetheless, several changes occur automatically rendering some of the provisions regarding a single-member company useless. According to art. 156 CCC, in a single-member company, the sole shareholder shall exercise all powers vested in the shareholders' meeting but the provisions on shareholders' meeting shall apply accordingly. As a result, some of the provisions shall apply directly without any modification, some shall require modification, whilst others shall not apply at all. In particular, the provision regarding a secret voting shall not apply to a single-member company, likewise there is no need to apply the provisions concerning formal convocation of the general meeting, since a sole shareholder may take up resolutions as the general meeting on any occasion because the entire share capital is continuously represented[4].

As regards the other provision relating to the single-member company, unless the law provides otherwise, art. 173 CCC foresees an obligatory written form of any declaration made towards the company by a sole shareholder where all shares in a company are held by such a shareholder or by a sole shareholder and the company, or else

ny may buy all the shares only after the registration or even earlier, but in every case after signing the articles of association of the company, e.g. J.A. Strzępka, E. Zielińska in: J.A. Strzępka, E. Zielińska, W. Popiolek, P. Pinior, *Kodeks spółek handlowych. Komentarz*, Warszawa 2015, p. 374; A. Kidyba, *Atypowe spółki handlowe*, Warszawa 2011, p. 28–31.

[4] Resolutions may be adopted without formally convening the shareholders' meeting if the entire share capital is represented and none of persons present objected as to the holding of the meeting or to placing any matters on the agenda (art. 240 CCC). In a single-member company, there is even no possibility of other person's objection if there is only one shareholder.



it shall be null and void. That means that in cases where the qualified form is required, such a declaration also requires a qualified form. A special provision deals with a situation when a sole shareholder is simultaneously a sole member of the management board, since in such case any legal act between such a shareholder and the company requires a notarial form, and the notary public shall notify the registry court of any such act by sending an extract from the notarial deed (art. 210 § 2 CCC)[5].

The said provisions are incorporated into the Polish law due to the implementation of the provisions of the Directive 2009/102/UE[6], which is the unified version of a former Directive 89/667/EEC[7]. These provisions shall be maintained in the proposal as 'Part 1 General Provisions'. According to art. 4 of the proposal, the single-member shall exercise the powers of the general meeting of the company and decisions taken by the single-member shall be recorded in writing. Art. 5 of the proposal states that contracts between the single-member and the company shall be recorded in writing, but Member States may decide not to apply such a requirement to contracts concluded under market conditions in the ordinary course of business which are not detrimental to the single-member company. The Polish law does not make any exceptions in that respect.

## The proposal of "*Societas Unius Personae*"

The said provisions of Part 1 of the Proposal shall apply to all single-member companies, independently of the legal statutes of such a company in Member States. However, the proposal makes a step forward and introduces a new form of the company called "*Societas Unius Personae*". In the preamble to the proposal, it is stated that in order to respect Member States' existing traditions of company

[5] There is also a special provision concerning a single-member company in organization (art 162 CCC), because in such case a sole shareholder shall not have the right to represent the company apart from filing the application for registration of the company to the registry court.

[6] OJ L 258, 1.10.2009, p. 20.

[7] Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited-liability companies, OJ L 395, 30.12.1989, p. 40.

law, flexibility should be afforded to them as regards the manner and extent to which they wish to apply harmonized rules governing the formation and operation of SUPs. Member States may apply Part 2 of the Directive to all single-member private limited liability companies so that all such companies would operate and be known as SUPs. Alternatively, they should provide for the establishment of an SUP as a separate company law form which would exist in parallel with other forms of single-member private limited liability company provided for in national law.

Thus, in order to choose the proper form of the implementation, first, the general provisions of the proposal must be analyzed, which concern the legal form, formation of the SUP, articles of association and its registration. Secondly, the provisions concerning the structure of the SUP, including share capital and the management system, must be examined.

### General provisions

According to art. 7 of the proposal, the "*Societas Unius Personae*" shall have legal personality and the single-member shall not be liable for any amount exceeding the subscribed share capital. The name of a company, which has the legal form of an SUP, shall be followed by the abbreviation "SUP". The SUP, and its articles of association, shall be governed by the national law of the Member State where the SUP is registered. The SUP shall have its registered office and either its central administration or its principal place of business in the Union. The SUP may be incorporated by a natural or legal person.

It is proposed that two different forms of establishing the SUP shall be admissible, namely by means of concluding a contract (articles of association) of a company or by conversion of a private limited liability company. The Commission shall adopt a uniform template of articles of association by an implementing act and it shall cover the questions of formation, shares, share capital, organization, accounts and the dissolution of an SUP. The uniform template of articles of association shall be made available by electronic means. An SUP shall be registered in the Member State in which it is to have its registered office and it shall acquire legal personality on the date on which it is entered in the register of companies. Member States shall ensure that



the registration procedure for newly incorporated SUPs may be completed electronically in its entirety without it being necessary for the founding member to appear before any authority in the Member State of registration (on-line registration).

Member States may only require for the registration of an SUP the following information or documentation:

- the name of the SUP;
- the address of the registered office, the central administration and/or the principal place of business of the SUP;
- the business object of the SUP; the names, the addresses and any other information necessary to identify the founding member;
- the names, addresses and any other information necessary to identify the persons who are authorized to represent the SUP in dealings with third parties and in legal proceedings;
- the share capital of the SUP and the nominal value of the single-share;
- the articles of association of the SUP.

Member States shall issue a certificate of registration confirming that the registration procedure has been completed. The certificate of registration shall be issued no later than three working days from the receipt of all the necessary documentation by the competent authority.

The second possibility of creating the SUP is the conversion of a private limited liability company. The formation of an SUP by conversion shall not result in any winding-up procedures, any loss or interruption of the legal personality or affect any rights or obligations existing prior to the conversion. The proposal refers to national law with regard to conversion procedures and the decision authorizing the company's conversion into an SUP shall be delivered to the registry court.

Taking into consideration the registration procedure in the proposal, it should be stated that the implementation would not require introducing many additional provisions into the Commercial Companies Code. First of all, the Polish private limited liability company may be formed by electronic means and also a uniform template of articles of association is used in that procedure. The obligatory content of the articles of association shall indeed require complying with the implementing act adopted by the Commission. As regards the registration procedure and information communicated to the registry court, the Polish regulation is also in consent with the proposal.

With reference to the formation of an SUP by conversion, the hitherto applicable provisions on company conversion laid down in the Commercial Companies Code shall comply with the terms and conditions of that procedure.

### The structure of "*Societas Unius Personae*"

The most significant difference towards the Polish private limited liability company is the regulation of the share capital. According to art. 16 of the proposal, the share capital of an SUP shall be at least one euro. In Member States in which the euro is not the national currency, the share capital shall be at least equivalent to one unit of that Member State's currency. Member States shall not impose any maximum value on the single share and shall ensure that the SUP is not subject to rules requiring the company to build up legal reserves but the reserves shall be built only in accordance with the articles of association. The capital of the SUP shall be fully subscribed. The consideration for the share shall be fully paid up at the moment of registration of an SUP.

As an SUP has only one shareholder, according to art. 15 of the proposal, an SUP shall not issue more than one share and this single share may not be split. Where in accordance with the applicable national law, a single share of an SUP is owned by more than one person, those persons shall be regarded as one member in relation to the SUP. They shall exercise their rights through one representative, who shall be recorded in the relevant register of companies.

Due to the fact that the share capital of a SUP may be minimum one euro only, art. 18 of the proposal foresees a solvency test for paying dividend to the shareholder which shall be created on two factors: first the value of the assets, and secondly the possibility to pay its debts. An SUP shall not make a distribution to the single-member if on the closing date of the last financial year the net assets as set out in the SUP's annual accounts are, or following such a distribution would become, lower than the amount of the share capital plus those reserves which may not be distributed under the articles of association of the SUP. The SUP shall not make a distribution to the single-member if it results in the SUP being unable to pay its debts as they become due and payable after distribution. The management



body must certify in writing that, having made full inquiry into the affairs and prospects of the SUP, it has formed a reasonable opinion that the SUP will be able to pay its debts as they fall due in the normal course of business in the year following the date of the proposed distribution ('a solvency statement').

Comparing the provisions of art. 15–20 of the proposal to the Polish Commercial Companies Code, it must be emphasized that the share capital system of the SUP is entirely different from the one envisaged for the Polish private limited company. Thus, in order to implement such a regulation the Polish legislator will have two alternatives, either to change the capital system of the Polish limited liability company, providing for the possibility of share capital reduction to one zloty (PLN) and introducing the solvency test instead, or to regulate the SUP as a different form of company. In my opinion, the second solution is definitively better. First of all, there would be no differences among limited liability companies in Poland[8], they would preserve the same statutes as before. Secondly, it would be easily recognizable for the customers and business partners that the SUP is a new form, although to a certain extent similar to Polish private limited liability companies, yet with a different share capital system.

Conversely, the SUP's management system is broadly similar to Polish companies. According to art. 22 of the proposal, the SUP shall be managed by a management body comprising one or more direc-

[8] The Proposal of the amendment of the Commercial Companies Code prepared by the Civil Law Codification Committee presented in 2010 (see also PPH 2010/12) assumed three different forms of limited liability company as for the share capital and its shares. The greatest objection of the opponents of the amendment was that such a diversity did not serve the protection of the economic turnover. The dispute will most certainly arise again in case of introducing the SUP as a different form of the limited liability company. See e.g. A. Kidyba, K. Kopczyńska-Pieczniak, *Spółka kapitałowa bez kapitału zakładowego – głos w dyskusji nad projektem zmiany kodeksu spółek handlowych*, PPH 2011/3, p. 9–15; A.W. Wiśniewski, *Reforma struktury majątkowej spółki z o.o. – uwagi do projektu nowelizacji kodeksu spółek handlowych*, PPH 2011/3, p. 16–21; W.J. Katner, A. Kappes, J. Janeta, *Kontrowersyjny projekt reformy struktury majątkowej spółki z ograniczoną odpowiedzialnością*, PPH 2011/4, p. 9–17; J. Frąckowiak, *Demontaż spółki z o.o. czy nowy rodzaj spółki kapitałowej – uwagi na tle proponowanej nowelizacji kodeksu spółek handlowych*, PPH 2011/6, p. 5–15; R. Pabis, *Projekt reformy przepisów o spółce z o.o. – głos w dyskusji*, PPH 2011/7, p. 16–24; S. Sołtysiński, *Kilka uwag o potrzebie modernizacji spółki z o.o.*, PPH 2011/9, p. 4–10; A. Opalski, *Kilka uwag na temat reformy spółki z o.o. i jej kontrowersyjnej krytyki*, PPH 2011/9, p. 11–14 and other papers contained in PPH 2011/9.

tors and the number of directors shall be specified in the articles of association. The directors shall be natural persons, or legal persons, where allowed by applicable national law. Appointment and removal of directors, as well as establishing their remuneration, belongs to the competences of the single-member, who shall appoint the directors for an unlimited period of time, unless otherwise specified in the single-member's decision appointing them, or in the articles of association. Nevertheless, the single-member shall be entitled to remove a director at any time by means of his decision.

According to art. 24 of the proposal, the management body shall have the authority to represent the SUP, including when entering into agreements with third parties and in legal proceedings. Directors may represent the SUP individually, unless the articles of association provide for joint representation. The management body is also competent to undertake any decision in the company, apart from the most important matters stated in art. 21 of the proposal granted for a single-member, such as: approval of the annual accounts, distribution of profits to the single-member, appointment and removal of the auditor, where applicable, alterations in the share capital and any other amendments to the articles of association, conversion of the SUP into another company form and dissolution of the SUP.

However, the influence of the single-member may be much greater, as according to art. 23 of the proposal, the single-member shall have the right to give instructions to the management body. Nevertheless, instructions given by the single-member shall not be binding for any director insofar as they violate the articles of association or the applicable national law. This is indeed a very interesting solution which may have its pattern in the German law, as in the German private limited liability company, the shareholders may issue binding instructions to the directors of the company (§ 37 GmbHG[9]). As regards the Polish Commercial Companies Code, it does not allow for such instructions to be issued directly, but the management board, according to art. 207 CCC, shall be subject to restrictions set forth in resolutions of

[9] Gesetz betreffend die Gesellschaften mit beschränkter Haftung vom 20. April 1892 (RGBl. S. 477 mit Änderungen).



the shareholder, and notably, the possibility of giving binding instructions to the management board is also supported by the literature[10].

## Conclusion

The proposal of the Directive of the European Parliament and of the Council on a single-member private limited liability company of 9 of April 2014 introduces a new form of company, which may be used in all Member States, called "*Societas Unius Personae*". This kind of company shall be treated as a form of private limited liability company, but according to the proposal, it shall have the minimum share capital of one euro only, and shall not have any requirements as regards creating legal reserves. Instead, it should use a solvency test in case of paying dividends to its shareholder. The proposal also regulates the matters of forming such a single-member company, its share system, the competences of the management board and the single shareholder. Even though most of the provisions of the proposal resemble the Polish private limited liability company, it is recommended that the SUP be regulated as a different form of company, since the share capital system of the SUP is entirely different and thereby such form may find acceptance of representatives and practitioners of business.

[10] P. Pinior, *Nadzór wspólników w spółce z ograniczoną odpowiedzialnością*, Warszawa 2013, p. 271–295.

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# AN OVERVIEW OF LEGAL REGULATION OF RELATED PARTY TRANSACTIONS AND CORPORATE GROUPS IN UKRAINIAN COMPANY LAW

## Introduction

The importance of legislative provisions, introducing substantive and procedural safeguards on related party transactions (RPTs), derives from the fact that the management and the majority shareholders are likely to abuse their rights and to harm minority shareholders or institutional investors with 'tunneling'[1]. Creditors, employees and other stakeholders would also feel the detrimental effect of a transaction, when assets are extracted from the company[2].

Despite some obvious negative consequences of RPTs, implying that a corporation would be stripped of its assets, leaving minority shareholders with less chance to receive dividends, there may be types of RPTs that due to transaction costs may prove to be more beneficial for the company than other available transactions. Situations, when RPTs become routine and are characterized as usual practice, have

[1] 'Tunneling is considered to be the diversion of corporate resources from the corporation (or its minority shareholders) to the controlling shareholder' as it is suggested in S. Johnson et al., *Tunneling*, "American Economic Review" 2000, Vol. 12, № 2, p. 26.

[2] L. Antonenko, *The Myth of Transformation Through EU Law: A Case-Study of the Company Law Reform in Ukraine* (September 18, 2009), available at SSRN: http://ssrn.com/abstract=1485607 orhttp://dx.doi.org/10.2139/ssrn.1485607, p. 9 [Retrieved June 15, 2016].



been well-demonstrated by L. Enriques with an example of imaginary state Tunelland[3], a developing economy with high risks of corruption and poorly managed tax system, which also somehow reminds of Ukraine. As the author pointed out, once a corporate group is in place, it will be harder to find RPTs suspicious, especially if businesses structured as corporate groups are a common organizational form within the economy[4]. Therefore, an outright prohibition of RPTs or fixing ceilings would not be a proper solution of shareholders' problems; this approach is too inflexible and may sometimes run against the interest of shareholders[5]. So, it remains to be investigated whether RPTs in corporate groups have to receive some special treatment comparing to transactions outside the groups.

Nevertheless, positioning RPTs as completely safe instruments of corporate governance would be a mistake, because, as M. Gelter alleged, the underlying concern is that directors and officers, if left unconstrained, will, on the one hand, squander the assets of the firm or shift them into their own pockets through self-dealing transactions, but on the other hand, frequently just not work hard enough to achieve the best possible result for shareholders[6]. That is why imperative limitations and requirements, obliging company's officers, shareholders and other potential related parties to follow certain rules when willing to enter into RPTs, need to be established.

## Theoretical Background

The following strategies for dealing with RPTs have been outlined in the famous book 'The Anatomy of Corporate Law: The Comparative and Functional Approach': affiliation terms, agent incentives,

[3] L. Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)*, "European Business Organisation Law Review" 2015, Vol. 16, p. 1–37.

[4] Ibidem, p. 5.

[5] K.J. Hopt, *Groups of Companies. A Comparative Study on the Economics, Law and Regulation of Corporate Groups*, ecgi Law Working Paper № 286/2015, February 2015, available at: http://ssrn.com/abstract=2560935, p. 15.

[6] M. Gelter, *Taming or protecting the modern corporation? Shareholder-stakeholder debates in a comparative light*, "New York University Journal of Law and Business" 2010–2011, Vol. 7, p. 657.

decision rights, and agent constraints[7]. This list of strategies is not exhaustive, there may be other responses to problems of self-dealing and RPTs, or combinations of the existing ones. For example, it is within the government's power to impose fines and prison terms for self-dealing transactions, although quite controversial as to how it may benefit the stock market development[8]. Some authors, when talking about possible solutions to self-dealing, also discuss nonintervention, which would prove to be an effective solution in a perfectly efficient market[9]. However, this is hardly imagined in a real world with numerous deficiencies and derogations. That is why offering and implementing strategies that may be grouped into 'ex ante' and 'ex post' types, or property rules and liability rules[10], seems inevitable.

Mandatory disclosure refers to affiliation terms and is widely used in many jurisdictions, with the highest requirements in the U.S.[11] In Europe disclosure rules on RPTs are dispersed between different sources of EU law, namely the Transparency Directive, obliging companies-issuers of shares to include major RPTs into interim management report (Art. 5(4))[12], and the Directive 2013/34/EU on the annual financial statements, regarding additional disclosures for medium-sized and large undertakings and public-interest entities (Art. 17)[13]. Some Member States have introduced more specific rules on disclosure, like in Italy[14], but even with the highest disclosure requirements, the

[7] L. Enriques, G. Hertig, and H. Kanda, *Related-Party Transactions*, [in:] R. Kraakman et al., *The Anatomy of Corporate Law: a Comparative and Functional Approach*, 2nd ed., Oxford University Press 2009, p. 155.

[8] S. Djankov et al., *The Law and Economics of Self-Dealing*, "Journal of Financial Economics" 2008, Vol. 88, p. 463.

[9] Z. Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, "California Law Review" 2003, Vol. 91, p. 405.

[10] Ibidem, p. 398.

[11] Supra 7, p. 156.

[12] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, Official Journal of the European Union, L 390/38-57.

[13] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, 29.6.2013, Official Journal of the European Union, L 182.

[14] Supra 7, p. 159.



effective regulation of large self-dealing transactions would need other safeguards, for instance, approval by disinterested shareholders[15].

The agents incentives strategy stems from the rule that the board is a trustee of shareholders, and is authorized to act on behalf of shareholders and for the company's benefit. For the approval of RPTs it makes sense provided that the board consists of disinterested members, and if this is not the case, then the procedure is less efficient, but still far less costly than the general meeting's approval and used in jurisdictions with the developed company law. For instance, according to the German Corporate Governance Code, extending loans from the enterprise to members of the Management and Supervisory Boards or their relatives requires the approval of the Supervisory Board (§ 3.9)[16]. The research has to show on how strong the faith in the carefulness and independence of the board has to be, so that it must be entitled to approve related party transactions.

The decisions strategy shifts the approval requirement from the board of the company to the general meeting of shareholders making the procedure more costly and cumbersome. Nevertheless, completely rejecting this kind of safeguard would be wrong for situations, when either the board consists of interested members only, or it is reluctant to take a decision on the approval. The question on whether to give shareholders a say on some non-routine RPTs, going beyond individual interests and concerning the interest of a company, or if we take a corporate group, concerning both the group interest and the interest of subsidiaries, will be subject to further investigation.

Last, but not least, the standards strategy, relies upon the fairness test, 'the duty-of-loyalty' doctrines, and supplements the enforcement mechanism of corporate law. The success of this strategy largely depends on the enforcement actors, while the problem with this idea is, again, that it is hard for a third party like a court or even an arbitrator to detect, let alone verify, private benefits extraction[17]. The way national courts interpret the 'duty of loyalty', that is the duty to control related-party conflicts and limit the risk of asset or infor-

[15] Supra 8, p. 463.

[16] German Corporate Governance Code, 5 May 2015, available at: http://www.dcgk.de//files/dcgk/usercontent/en/download/code/2015-05-05_Corporate_Governance_Code_EN.pdf [Retrieved June 15, 2016].

[17] Supra 3, p. 8.

mation diversion[18], depends on the party, which is accused of breaching the duty of loyalty: an officer, a shareholder or a parent company in a group. Another problem with the standards strategy is that the common-law notion of fiduciary duty is associated with a high level of judicial discretion to assess the terms of transactions and to make rules, thus being at odds with the civil-law emphasis on legal certainty[19]. So, with civil-law countries this strategy, although more flexible[20], may not be used as freely as in common-law countries, and even if fully allowed, it has been demonstrated in the recent study on the three continental European countries laws on self-dealing (France, Germany and Italy) that liability suits remain rare compared in those countries to the US[21]. Thus, it poses a question about the effectiveness of standards strategy as opposed to incentives and decision rights strategies, gathered under the umbrella of 'self-enforcement' model, when company itself has the necessary instruments to regulate corporate matters. The rationale for self-regulation, rather than court or regulator enforcement in this area, is that corporate governance codes enter into very sensitive and intricate areas. It is especially difficult to find the proper fair solution when it comes to corporate groups, where the traditional corporate constituencies (management, shareholders and other stakeholders) are complicated by different levels of corporate ownership.

In addition, rules providing for strategies on RPTs must be proportionate to the harm RPTs may bring, so that routine or beneficial agreements are out of their scope. Listed companies may enter into entirely fair RPTs[22], and legal tunneling takes places in developed countries as well[23]. Taking into account that every company is a separate mechanism of inner operations governed by conflicting interests and complicated rules, being even more sophisticated in corporate groups, it is unlikely that in these areas the rulemaker is capable

[18] Supra 7, p. 173.
[19] Supra 1, p. 24.
[20] Supra 9, p. 407.
[21] P.-H. Conac, L. Enriques, & M. Gelter, *Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy*, ECFR 2007, Vol. 4, p. 528.
[22] Supra 3, p. 7.
[23] Supra 1, p. 26.



of producing a single solution which fits all companies[24]. For this reason some degree of flexibility for companies is required for efficiency reasons[25]. It however remains to be seen how flexible the legislation should be in regard to RPTs.

## Legislation in Ukraine

Rules on related party (non-arm's length) transactions were implemented in Ukrainian laws with the adoption of the Law of Ukraine *On Joint-Stock Companies* on 17 September 2008, which partly took effect on 29 April 2009 and was fully enforced in 2011 (the Law *On JSC*)[26]. The first version of Article 71 of the Law *On JSC* provided for two main kinds of related parties: (1) company's officers, and (2) shareholders having 25 or more per cent of ordinary shares.

Persons affiliated to company's officers or to shareholders, also understood as related parties, according to Article 1 of the Law *On JSC* included their family members (husband or wife), parents (adopters), guardians, brothers, sisters, children and their husbands (wives) jointly carrying out economic activity. It could also be the other way round, so that, for example, adopted persons or persons under guardianship were also considered affiliated to their adopters or guardians. The notion of affiliated persons additionally included legal entities controlled by company's officers or by shareholders, or in case of shareholders-legal entities – physical or legal persons controlling those shareholders.

Later on with the Law of Ukraine *On Amending the Law of Ukraine 'On Joint-Stock Companies' on Improving the Mechanism of Activity of Joint-Stock Companies*[27], as of 03 February 2011, Article 71 was amended in a way that all the above mentioned affiliated persons were list-

[24] P.L. Davies & K.J. Hopt, *Corporate Boards in Europe – Accountability and Convergence*, "The American Journal of Comparative Law" 2013, Vol. 61, p. 371.
[25] S. Shidhar & V. Bruno, *One Size Does Not Fit All, After All: Evidence from Corporate Governance*, 2007, available at: http://ssrn.com/abstract=887947.
[26] Published in Vidomosti Verkhovnoii Rady Ukraiiny, 2008, Vol. 50, Art. 384. Retrieved June 15, 2016 from: http://zakon4.rada.gov.ua/laws/show/514-17 .
[27] Published in Vidomosti Verkhovnoii Rady Ukraiiny, 2011, Vol. 35, Art. 344. Retrieved June 15, 2016 from: http://zakon3.rada.gov.ua/laws/show/2994-17/ed20110302.

ed directly in Article 71, which has not changed things considerably, but added more ambiguity to its wording.

As provided by the Article 71 of the Law *On JSC*, for a transaction to be understood as RPT, the above indicated persons need either to be parties, representatives or agents in the transaction, or to receive money or property from the company or from the other party in a transaction. If they meet the criteria for RPTs, they must inform the company within 3 working days after the interest arose. Upon the receipt of this information the executive board shall inform within 5 working days the supervisory board, where disinterested board members may approve, refuse to approve it or pass this issue to the general meeting of shareholders, so that the latter decides on it.

Having implemented rules on RPTs for joint-stock companies Ukraine has put itself ahead of the EU standards, because RPTs are still subject to discussion at the EU level[28]. As a source of inspiration the drafters used the Russian law on joint-stock companies, which in turn is a reflection of the 'self-enforcing' model of company law, proposed by B. Black and R. Kraakman[29], differing from prohibitive and enabling models. The scholars called the latter models ideal ones, as their requirements are opposite in essence. The self-enforcement model borrowing some features from other models was designed to ensure maximum protection of stakeholder rights in an emerging unstable and non-democratic economy. Ukraine has been in a similar position. Corruption and bureaucracy have tied Ukrainian economy making it unattractive for investors. The self-enforcing problem proposed solutions to the outlined problems, namely through enforcement, as much as possible, through actions by direct participants in the corporate enterprise (shareholders, directors, and managers), rather than indirect participants (judges, regulators, legal and accounting professionals, and the financial press)[30].

Unfortunately, the self-enforcing model was not fully preserved in the Law *On JSC*, and it lost some aspects of transparency, mutual control and practice of corporate governance[31]. Some of the key concepts featuring the self-enforcing model have been missed, such as transaction approval by independent directors, independent shareholders, or both, and some rules on RPT, contained in foreign legislation, were eroded, namely rules on market-price test[32].

[28] A. Radwan, *Ukrainian Corporate Law: Model for Others, or in Need of a Model?*, "European Company Law" 2015, Vol. 12, № 5, p. 216.

[29] B. Black & R. Kraakman, *A Self-Enforcing Model of Corporate Law*, "Harvard Law Review" 1996, Vol. 109, pp. 1911–1982.

[30] Ibidem, p. 1916.



To fix the existing gaps in Article 71 of the Law *On JSC* on 07 April 2015 the Law of Ukraine *On Amending Certain Legislative Acts of Ukraine on Protection of Investors* was adopted[33]. *Inter alia* it has introduced new rules for RPTs[34]. The Law has established that transactions in the amount less than 100 minimum salaries are not covered by the rules on RPTs. The supervisory board under the Law is authorized to approve RPTs, but in case there is no supervisory board (possible in private joint-stock companies), or where all its members are related parties, or if the market price exceeds 10 % of financial assets of the company according to the last annual report, then it is for the general meeting of shareholders to approve this transaction.

With the enactment of the Law adopted on 07 April 2015[35] rules on RPTs have been enriched with mandatory disclosure of provisions of RPT for public joint-stock companies, prohibition for interested shareholders to vote on the approval of RPT at the general meeting of shareholders, and prohibition of preliminary approval of fundamental RPTs.

Further enforcement of mechanism regarding RPTs in Ukrainian law would correspond to the self-enforcing model of corporate law. Ukraine is a typical example of developing economy, where institutional means are not sufficient to tackle problems of corporate law, the 'market' cannot fill regulatory gaps that an 'enabling' model leaves behind[36].

[31] A. Yefymenko, *Corporate Governance under Ukraine's New Joint Stock Company Law*, electronic copy retrieved June 15, 2016 from: http://ssrn.com/abstract=1387360.

[32] Supra 2, p. 24.

[33] Published in Vidomosti Verkhovnoii Rady Ukraiiny, 2015, Vol. 25, Art. 188. Retrieved June 15, 2016 from: http://zakon4.rada.gov.ua/laws/show/289-19.

[34] I. Romashchenko, *Corporate Law Development in Ukraine: From Post-Soviet Past to European Future*, "European Company Law" 2015, Vol. 12, № 5, p. 221.

[35] In accordance with paragraph 1 of the Ending provisions, the Law will take effect on 1 May 2016.

[36] Supra 2, p. 8.

However, Ukrainian corporate lawyers, who have been acquainted with 'raider attacks' would agree with the statement of L. Enriques that no regulation on RPTs (on tunneling) can succeed in preventing (minority) shareholder expropriation in the absence of sophisticated enforcement actors, i.e. experienced courts and/or active, committed securities regulators, operating in a social context that reject tunneling as a business practice[37]. That means that even with the so-called 'self-enforcing' model of company law attention has to be paid to standards-based strategy described above; self-regulation, where there is limited or no outside monitoring, is unlikely to be successful[38].

[37] Supra 3, p. 4.

[38] A. de Jong et al., *The Role of Self-Regulation in Corporate Governance: Evidence and Implications from the Netherlands*, "Journal of Corporate Finance" 2005, Vol. 11, p. 500.

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# REGULATION OF THE PROCEDURE OF ALIENATION OF A SHARE IN THE AUTHORIZED CAPITAL UNDER THE CONTRACT OF SALE IN LIMITED LIABILITY COMPANIES

Despite a long period of its establishment and development, corporate legislation of Ukraine requires further improvement and adjustment to high standards of European legislation. Currently, a matter of urgency is an issue of legal regulation of operation of limited liability companies (hereinafter – LLCs), since it is one of the most common legal forms of business companies that is chosen by both domestic and foreign investors for doing business in Ukraine, especially in the western region of the country. In particular, along with an opportunity to establish new LLCs or to inherit a share, one of the ways to acquire a share in the authorized capital of an LLC is to purchase corporate rights from LLCs that exist in the capital market for a certain period of time and have adequate business reputation.

The procedure of alienation of corporate rights from an LLC under a contract of sale is governed in accordance with Art. 147 of the Civil Code of Ukraine[1] (hereinafter – CC) and Art. 53 of the Law of Ukraine "On Business Associations"[2]. Pursuant to these norms, it is

[1] Civil Code of Ukraine № 435-IV as of 16 January 2003, 40–44 *Bulletin of the Verkhovna Rada of Ukraine* 356 (2003). Retrieved June 15, 2016 from: http://zakon2.rada.gov.ua/laws/show/435-15.

[2] Law of Ukraine "On Business Associations" № 1576–XII as of 19 September 1991, 49 *Bulletin of the Verkhovna Rada of Ukraine* 682 (1991). Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/1576-12.

provided that a member of a company may sell or otherwise cede his share (a part thereof) in the authorized capital. The given provision defines a share in the authorized capital of a company as a separate object of civil rights. When turning to grammatical interpretation of the phrase "a share in the authorized capital", literal understanding implies that a share is a part of the authorized capital. On this matter, I. V. Spasybo-Fatieieva notes that the authorized capital does not exist separately as an object of civil law. The authorized capital is a concept of accounting adopted by law for its purposes[3].

If to refer to provisions of law, according to the Law of Ukraine "On Business Associations", the authorized capital of a company is formed of contributions that may take the form of money, securities, other tangibles, property rights or other alienable rights having monetary valuation (Part 1, Art. 13). The peculiarity of making such contributions to the authorized capital of a company is that they become the company's property and not that of its members (founders). When acquiring the status of a member of a company, a person becomes endowed with a set of rights and obligations with regard to the company that is defined by the size of his share in the authorized capital. The foregoing implies that the term "a share in the authorized capital" is identical to the concept of "corporate rights" conferred to a person acquiring the status of a member of a company. Therefore, as a subject matter of a contract, a share is a legal form that defines a set of property and non-property rights. Yet, in law enforcement practice, the concept of "a share in the authorized capital" is interpreted differently: in some cases, it is a set of property and non-property rights of a member (corporate rights); in other cases, it is property rights of a member. As a result, the subject matter of a contract of sale is defined as either corporate rights or a share in the authorized capital. Along with that, since the contract stands as an independent regulator of social relations, there appear differences in determining the mechanism for transition of corporate rights or a share in the authorized capital. Consider the procedure of alienation of a share in the authorized capital of LLCs under the contract of sale in more details.

[3] I.V. Spasybo-Fatieieva, *Civil Law: Towards formation of Doctrines: Selected research papers*, Kharkiv 2012, p. 125.



In the letter of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship № 5410 as of 24 April 2010 "Regarding Documents on Transition or Transfer of a Share in the Authorized Capital of a Limited Liability Company", it is stated that a share (a part thereof) in the authorized capital of an LLC can be transferred on the basis of a contract of sale, a contract of exchange, a deed of gift[4]. Members of an LLC bear corporate rights in it and may alienate a share in the authorized capital to other company's members and the company itself.

In addition, Art. 147 of the CC and Art. 53 the Law of Ukraine "On Business Associations" provide that a member of an LLC may sell his share (a part thereof) to third persons, unless otherwise is established by the charter of a company. That is, whether it is permitted or prohibited to alienate a share in the authorized capital to third persons may be determined by the charter of an LLC. "Third persons" should be understood as persons who are not members of an LLC whereof a share in the authorized capital is being alienated at the time of purchase of a share.

Also, the legislation in force contains a number of restrictions on the free movement of a share in the authorized capital of LLCs. When concluding a contract of sale, there is a rule on the priority right to purchase a share in the authorized capital. The substance of the priority right is that members of a company shall have a principal right to purchase a share if a member of an LLC intends to sell it to a third person. Should members of a company not exercise the priority right to purchase a share in the authorized capital, this right passes to the company and / or third persons. Along with that, the consent of company's members to alienate a share in the authorized capital is not required.

However, an LLC may insert into the charter a provision whereby third persons may or may not have the right to purchase a share even in case members of a company do not exercise the priority right to purchase this share, namely:

1) The charter of an LLC does not provide for prohibition to alienate a share in the authorized capital of a company. When concluding

[4] Letter of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship № 5410 as of 24 April 2010 "Regarding Documents on Transition or Transfer of a Share in the Authorized Capital of a Limited Liability Company". Retrieved June 15, 2016 from: http://search.ligazakon.ua/l_doc2.nsf/link1/DP2888.html.

a contract of sale, a member who intends to sell a share in the authorized capital has to comply with provisions of law on the priority right to purchase a share by other members. In this case, a company is guided by regulatory provisions defined in law.

2) The company's character provides for prohibition to alienate a share in the authorized capital of a company to third persons in certain instances, such as concluding a deed of gift, a contract of exchange, and so on. Still, in what relates to the right to sell a share in the authorized capital, an LLC is guided by Clause 2, Part 2, Art. 147 of the CC providing for the priority right of other members to purchase a share that is being alienated. Should members of a company not exercise their priority right to purchase a share, the right of purchase passes to third persons. However, in the event a member of a company sells a share in the authorized capital without notifying other LLC members thereof, the latter shall have the right to bring an action on transferring rights and obligations of the buyer on them, as per Part 4, Art. 362 of the CC.

3) The charter of an LLC provides for prohibition of alienation of a share in the authorized capital, including sale of this share to third persons. That is to say that prohibition applies to all ways of alienation. In this case, members of an LLC are entitled not to admit membership of third persons in a company altogether. Still, a member who intends to sell his share in the authorized capital may conclude a contract of sale with other members or the company. Should a share in the authorized capital be acquired by the company itself, the latter shall not be passed corporate rights of a member. The company is obliged within a year since acquiring a share in the authorized capital to sell it to other persons or reduce the authorized capital. Should neither members nor the company exercise their right to purchase a share in the authorized capital, a member may withdraw from the company. A member shall exercise this right by filing an application for withdrawal and send it to the company in a manner prescribed by law. In this case, the company's right to purchase a share in the authorized capital becomes the company's obligation to pay off a member who has exercised the right to withdraw from the company.

Thus, in order to conclude a contract of sale of a share in the authorized capital a member is obliged to notify the company and its members of selling a share. The procedure of notifying the company is



not envisaged by law, so relevant provisions are to be prescribed in the LLC charter. This can be done either by giving a written notice to each member of a company or announcing sale of a share at the general meeting of an LLC. In his notice, a member has to inform the size of a share that is being sold, the price and other terms. Normally, along with the notice of sale of a share in the authorized capital there is given a draft contract wherein terms of purchase of a share are proposed. Such contract terms are to be equal for both members who enjoy the priority right to purchase a share and third persons. The notice of sale of a share in the authorized capital is to be given one month prior to the actual sale.

According to Part 2, Art. 147 of the CC, should company members reveal the intention to exercise the priority right to purchase a share (a part thereof), they are entitled to acquire a share pro rata to amounts of their shares. At the same time, the charter or agreement between members may contain other terms for distribution of a share that is being alienated. They may alter proportionality of a share by increasing or reducing the size of the alienated share in the authorized capital to be distributed among them. However, members do not enjoy the priority right to purchase a share in the authorized capital in relation to each other. Should members of an LLC not exercise the priority right to purchase a share within a month since being notified of sale of a share, the right of purchase passes to the company and third persons. Along with that, the term during which members are entitled to exercise the priority right to purchase a share in the authorized capital may be altered in the charter or by agreement between members of an LLC. Therefore, under the legislation in force, the procedure of alienation of a share in the authorized capital of an LLC may be established by the company's charter or agreement between members.

Alienation of a share to the authorized capital is also conditioned upon its payment. A member of an LLC may sell a share (a part thereof) in the authorized capital only to the extent, to which it has been paid by the member (Part 3, Art. 147 of the CC). The foregoing provision reflects the rule that no one can transfer to another more rights than he has. After all, upon the size of a share in the authorized capital there depends the amount of corporate rights of a purchaser of a share. A member may sell either the whole share or a part thereof, in which case he remains the member of the company with a share

smaller in size. Yet, in law enforcement practice, there often arise situations when a member sells the paid part of a share in the authorized capital, while still owning the part that is unpaid.

In notarial practice, there is a rule that when concluding a contract on alienation of a share in the authorized capital of an LLC, a member is to present the certificate (Art. 52 of the Law of Ukraine "On Business Associations") that attests making a contribution to the company's authorized capital, as well as the corresponding extract from the Unified State Register of Legal Entities and Individual Entrepreneurs indicating a share of the member in the authorized capital. The latter requirement is not provided by the legislation in force, but is dictated by notaries' practice and is not thus mandatory[5].

However, an issue of the most practical importance concerns determining the moment of transition of corporate rights from a company's member to other persons. Corporate legislation of Ukraine does not envisage since which moment corporate rights pass to a purchaser of a share. In the letter of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship № 5410 as of 24 April 2010, it is stated that when a share is being transferred from one member to another, transition of ownership of the property shall be formalized in a document pursuant to requirements of Chapter 24 of the CC[6]. Art. 208 and Art. 209 of the CC provide for cases of conclusion of transactions in writing and prescribe that a transaction performed in writing shall be notarized only in cases established by law or parties' agreement. If to analyze provisions of Chapter 54 that defines general terms of sale, it follows that the CC does not envisage notarization of the contract of sale of a share in the authorized capital of a company. Therefore, as a general rule, the contract of sale of a share in the authorized capital may be concluded in a simple written form. Notarization of the contract may be performed by agreement of contracting parties, but is not mandatory.

[5] O. Parkhomenko, *How to Sell a Share? – Practical Issues (The Example of Kharkiv Region)*, "Yurydychnyi Radnyk" 3(39) (June 2008). [the original title of paper: О. Пархоменко, *Як продати частку? – практичні питання (на прикладі Харківського регіону)*] Retrieved June 15, 2016 from: http://www.ilf-ua.com/ua/publications/articles/yak_prodaty_doliu/.

[6] Letter of the State Committee of Ukraine for Regulatory Policy and Entrepreneurship № 5410 as of 24 April 2010 "Regarding Documents on Transition or Transfer of a Share in the Authorized Capital of a Limited Liability Company". Retrieved June 15, 2016 from: http://search.ligazakon.ua/l_doc2.nsf/link1/DP2888.html.



At the same time, Art. 334 of the CC establishes that the moment when ownership is acquired under the contract may be either the moment of transfer of the property or notarization or state registration of the contract. Since special rules of law do not provide for the form of the contract of sale of a share in the authorized capital and the moment of transition of corporate rights under the contract of sale, one should pay attention to the following. Part 1, Art. 87 of the CC stipulates that a legal entity of private law may be established and operate on the basis of a model charter. The Resolution of the Cabinet of Ministers of Ukraine № 1182 as of 16 November 2011 has adopted the model charter of a limited liability company wherein Clause 20 prescribes that along with transfer of a share (a part thereof) to a third person, the latter is passed all rights and obligations held by a company member who has ceded a share in whole or in part[7]. The cited provision effectively duplicates Art. 53 of the Law of Ukraine "On Business Associations" before amended by the Law № 997-V as of 27 April 2007 and determines the moment of transition of corporate rights to a new member, which is the moment of signing the contract.

In addition, according to provisions of the Resolution of the Plenary Supreme Court of Ukraine as of 24 October 2008[8], in order to become a member, it suffices to conclude a contract of sale of a share in the authorized capital. Amendments to the charter and state register do not affect deciding the matter of joining the company by a new member.

On the one hand, one may agree with such conclusions, since the legislation in force does not contain a mandatory rule that would prohibit alienating corporate rights to third persons under the contract. Moreover, the law entitles members (founders) to prohibit alienation of a share in the authorized capital in rules of a local nature, in particular the company's charter. Therefore, should members of a com-

[7] Resolution of the Cabinet of Ministers of Ukraine № 1182 as of 16 November 2011 "On Adoption of the Model Charter of a Limited Liability Company". Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/1182-2011-%D0%BF.

[8] Resolution of the Plenary Supreme Court of Ukraine as of 24 October 2008 "On Judicial Practice in Corporate Disputes", 11 *Bulletin of the Supreme Court of Ukraine* (2008), Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/v0013700-08.

pany not exercise their priority right and the company's charter not contain prohibition to alienate a share, the moment when ownership of a share is acquired under the contract may be the moment of acquisition of corporate rights. In this case, the company has no objection against accepting a new member.

On the other hand, acquiring of a share in the authorized capital under the contract is just one of legal facts of acquiring corporate rights in a company, which is followed by amendments to the charter and state register. Pursuant to Part 1, Art. 51 of the Law of Ukraine "On Business Associations", Part 1, Art. 88 and Part 1, Art. 143 of the CC, the constituent documents of an LLC are to contain information on the composition of founders and members, the size of shares of each of the members, as well as the procedure of joining the company and the procedure of transition of a share in the authorized capital. Furthermore, as per Part 5, Art. 89 of the CC, amendments to the constituent documents of a legal entity shall come into force for third persons on the date of state registration. Should information on the new member not be entered into the state register, he shall not be able to dispose of his share and perform its alienation.

If to refer to judicial practice of the Supreme Economic Court of Ukraine, in the Resolution № 4 as of 25 February 2016[9], it is stated that ownership of a share in the authorized capital of an LLC arises with a third person since the moment of contract conclusion, unless otherwise is agreed by the parties (Art. 363 of the CC). Still, the right to participate in a company is a personal non-property right acquired by a third person only upon joining the company, which is to be confirmed by the corresponding decision of the general meeting of company members.

However, as practice shows, there quite often arise situations when there is a considerable period of time between the moment of acquiring ownership of a share and the moment of acquiring the legal status of a company's member. This may be due to abuse of the law on the part of other company members who do not intend to admit a purchaser of a share to management of the company. In this case, the person,

[9] Resolution of the Supreme Economic Court of Ukraine № 4 as of 25 February 2016 "On Certain Issues of Practice of Resolution of Disputes that Arise out of Corporate Relations". Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/v0004600-16.



although owning a share in the authorized capital, is unable either to participate in managing the company, since no amendments on the composition of members are introduced into the constituent documents, or to dispose of his share, since information on him as a new member is not entered into the state register so far.

This is due to the fact that the legislation in force does not contain a provision on the obligation to notify persons who have acquired a share in the authorized capital of the general meeting, which often leads to ignoring the new purchaser of a share. Thereby, there arise situations when a person acquires a share under the contract of sale, whereas at the general meeting, members vote not for accepting the purchaser of a share as a new member, but dilute a share sold by increasing the authorized capital and increasing the size of their shares in it. As a result, amendments on the composition of members are introduced into the charter at the subsequent general meeting, and the person who becomes a company's member acquires a share in the authorized capital, but the scope of corporate rights diminishes, since there diminishes a share of the member joining the company. Along with that, the decision of the general meeting held by the time a person has acquired the status of a member, shall not be subject to appeal, since at the time of holding the general meeting, a purchaser of a share had not yet been a member of the company.

Hence, due to ambiguity of statutory, charter and contract regulation in both law enforcement practice and scholarly literature, they distinguish three approaches to determining the moment of acquisition of corporate rights under the contract. These approaches are the following: 1) rights and obligations of a company member arise since the moment of state registration of amendments to the constituent documents; 2) the moment of taking a decision on amending the constituent documents at the general meeting of a company is the moment of acquiring corporate rights in the company; 3) the moment of concluding a contract on alienation of a share in the authorized capital of a company is the moment of emergence of corporate rights.

If to analyze the given approaches, one should note the following. Provisions of the legislation in force providing for state registration of amendments to the constituent documents prescribe that these data is primarily a guarantee of reliability of information on a company for third persons. However, when acquiring a share in the authorized

capital, a person gains corporate rights with regard to a company and not other (third) persons, which does not reflect the need to bring the moment of acquiring corporate rights to the moment of state registration of amendments to the constituent documents.

In case taking a decision by the general meeting on joining a company by a person is considered as the moment of acquiring corporate rights, there arises a question on whether it is expedient to introduce in the legislation such restrictions as priority rights of members to purchase a share in the authorized capital, the possibility to secure in the charter prohibition to alienate a share in the authorized capital to third persons. Thus, as a general rule, members themselves are those who introduce amendments to the constituent documents. Therefore, the amendment on the member composition takes effect for the members since the moment of taking a decision on amending the constituent documents (the charter). Yet, this condition serves as another restraint to a purchaser of a share in the authorized capital and actually stands as a negative factor that violates rights of third persons who have acquired a share under the contract in good faith.

Thus and so, it would be reasonable to prescribe in corporate legislation that the moment of concluding a contract on alienation of a share is the moment of acquisition of corporate rights. Furthermore, it is necessary to introduce provisions that amend the procedure of alienation of corporate rights under the contract. After all, an LLC is a legal entity that is founded by bringing together first of all property, not persons. Therefore, it seems reasonable to minimize the possibility to restrict the movement of corporate rights provided by a company to its members. Considering this, the contract should be the only ground for acquiring corporate rights, while introducing amendments to the charter and state register should be actions aimed to confirm this fact.

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# LEGAL INSTITUTION OF THE SHARE REGISTER UNDER POLISH CODE OF COMMERCIAL PARTNERSHIPS AND COMPANIES IN COMPARISON TO CZECH AND SLOVAK REGULATIONS

## Preliminary remarks

Problematic aspects and legal character of the share register are the subject matter of an animated discussion in the Polish doctrine[1]. The share register is an internal document of joint-stock company

[1] See more: A. Opalski in: A. Opalski (red.), *Kodeks spółek handlowych. Tom IIIa. Spółka akcyjna. Komentarz – art. 301–392*, Warszawa 2016, p. 826–845; W. Wyrzykowski, *Nawiązanie stosunku członkostwa w spółce akcyjnej*, [in:] J. Olszewski (red.), *Tendencje reformatorskie w prawie handlowym. Między teorią a praktyką*, Warszawa 2015, C.H. Beck, p. 263–268; W. Popiołek in: J.A. Strzępka (red.), *Kodeks spółek handlowych. Komentarz*, Warszawa 2015, p. 822–830; M. Rodzynkiewicz, *Kodeks spółek handlowych. Komentarz*, Warszawa 2014, p. 663–673; R. Pabis in: Z. Jara, *Kodeks spółek handlowych. Komentarz*, Warszawa 2014, p. 1291–1297; S. Sołtysiński, M. Mataczyński in: S. Sołtysiński, A. Szajkowski, A. Szumański, J. Szwaja, A. Herbet, M. Mataczyński, I.B. Mika, T. Sójka, M. Tarska, M. Wyrwiński, *Kodeks spółek handlowych. Tom. III. Spółka akcyjna. Komentarz do art. 301–490*, Warszawa 2013, p. 337–358; T. Siemiątkowski, R. Potrzeszcz in: T. Siemiątkowski, R. Potrzeszcz, *Kodeks spółek handlowych. Komentarz*, Warszawa 2012, p. 260–273; A. Kidyba, *Kodeks spółek handlowych. Komentarz T. II, Komentarz do art. 301–633*, Warszawa 2010, p. 252; A. Opalski in: S. Sołtysiński (red.), *System Prawa Prywatnego*, t. 17B, *Prawo spółek kapitałowych*, Warszawa 2010, p. 276–279; Z. Opałko, *Księga udziałów i księga akcyjna w spółkach kapitałowych*, "Prawo spółek" 1999, Nr 10, p. 23; G. Wołak, *Charakter prawny i skutki wpisu do księgi akcyjnej*, "Prawo spółek" 2011, Nr 7–8, p. 84 et seq.

which determines the formal entitlement to act of those persons that are entitled under registered shares (*akcje imienne*) or temporary certificates (świadectwa *tymczasowe*). Pursuant to Art. 343 § 1 of the Polish Code of Commercial Partnerships and Companies[2], in relations with the company, only a person who is registered in the share register or has possession of a bearer share, without prejudice to the provisions on trading in financial instruments, shall be deemed a shareholder. A procuration of the legal title to a registered share or to a temporary certificate does not thereby create for shareholder any formal entitlement towards joint-stock company.

The main aim of the share register is to ease a designation which shareholder (alternatively: pledgee, usufructuary or possessor of temporary certificate) is entitled to act in particular join-stock company. The management board can essentially rely on this information which is in the share register, because this body of company does not have any obligation to check that registers are correct and complete with the actual circumstances.

In actual fact the liability to keep the share register lies basically on the management board of the joint-stock company. Under the provision of Art. 342 of the Polish Code of Commercial Partnerships and Companies, the joint-stock company may commission a bank or investment company in the Republic of Poland to keep the share register. This delegation of organizational powers, which appertain to management board, is one of the few examples of statutory permissions, because when there is no clear statutory norm to delegate the power, any delegation of power should be not permissible.

The share register may be kept both in paper and in electronic form under the Polish legal order. When the share register will be kept in paper form, it should be provided as a group of stitched pages with proper data exposed. The Polish legislator does not stipulate any specific form and restriction to the storage device in the case of the electronic form of a register share. According to that, it may be an internal data storage device (e.g. a special program installed on computer

[2] The Code of Commercial Partnerships and Companies of September 15, 2000, Journal of Laws, 2000.94.1037.



which is in the seat of a company) and also an external data storage device (e.g. SD card or USB flash drive etc.)[3].

An institution, which is similar to the Polish share register, was also provided by the Czech and Slovak legislation. The Czech and the Slovak legislator in contrast to the Polish legislator uses directly the term "the register of shareholders" (Czech: *seznam akcionářů*; Slov. *zoznam akcionárov*). Despite the terminological difference, the substance of this institution is the same as in Poland.

Pursuant to the § 264 sec. 1 of the Czech Commercial Companies Act, a registered share shall be registered in the register of shareholders kept by the company. Where a company issued book-entry shares, the statutes may provide that the register of shareholders is substituted by a book-entry securities register[4]. It is emphasized in the Czech legal literature that the body which is liable to keep the register of the shareholders is the management board[5].

It seems that the Slovak legislator is much more succinct than Polish and Czech legislator, when it comes to register of possessors of registered shares. Pursuant to § 156 sec. 6 sentence 1 of the Slovak Commercial Code, the joint-stock company that issued registered shares shall guarantee keeping the register of shareholders, which may be kept according to this Act and special provisions. Interestingly, the Slovak legislator mandated strikingly different construction of the subject which keeps the register of shareholders. The register of shareholders shall be kept by the Central Securities Depository of the Slovak Republic[6]. The keeping of the register of shareholders by the Central Securities Depository of the Slovak Republic is obligatory in the case of registered shares. This obligation was imposed by the Slovak legislator in § 107 sec. 12 of the Securities Act. According to this provision

[3] Cf. T. Siemiątkowski, R. Potrzeszcz in: T. Siemiątkowski, R. Potrzeszcz, *Kodeks spółek handlowych. Komentarz*, Warszawa 2012, p. 260.

[4] More about book-entry shares in the new Czech Commercial Companies Act, see: P. Čech, B. Havel, *Akcie ve víru rekodifikace aneb nevtělené, zaknihované a kusové akcie v návrhu zákona o obchodních korporacích*, "Obchodněprávní revue" 10/2011, p. 294 et seq.

[5] Cf. I. Štenglová in: I. Štenglová, B. Havel, F. Cileček, P. Kuhn, P. Šuk, *Zákon o obchodních korporacích. Komentár*, Praha 2013, p. 458.

[6] L. Žitnaňská in: O. Ovečková a kol., *Obchodný zákonník. Komentár*, Bratislava 2012, p. 730; M. Patyaková in: M. Patyaková a kol., *Obchodný zákonník. Komentár*, Bratislava 2010, p. 467.

the joint-stock company is obliged to conclude immediately an agreement on keeping the register of shareholders with the Central Securities Depository of the Slovak Republic. On the other hand, when the joint-stock company has book-entry shares (dematerialized shares), the register of shareholders can be replaced by issuer's register (Slov. *register emitenta*)[7]. A legal construction applied by the Slovak legislator is not an obstacle to keep by the Slovak joint-stock companies also an internal register of shares (or shareholders)[8].

## The obligation to keep the register of shares

The obligation to keep the register of shares was directly stipulated in Art. 341 § 1 of the Polish Code of Commercial Partnerships and Companies. Pursuant to the wording of above mentioned provision, the management board shall keep the register of registered shares and temporary certificates. The point at issue in the Polish legal literature is to determine the moment, when arises the obligation to keep this register. In opinion of the part of representatives of doctrine indispensability of creating and keeping the share register arises in moment when a registered share or temporary certificate was issued. According to that this obligation comes into being when just only one share certificate was issued. The raised point has the great importance because of many reasons. It should be mentioned e.g. the civil liability to the company of the members of its management board under the provision of Art. 483 of the Polish Code of Commercial Partnerships and Companies and criminal liability of these persons that was stipulated in Art. 594 § 1 pt 2 of the Polish Code of Commercial Partnerships and Companies. It should be also emphasized that the members of the management board are liable to shareholders pursuant to the general provisions, when they caused damage due to their fault[9].

[7] Cf. L. Žitnaňská in: O. Ovečková a kol., *Obchodný zákonník. Komentár*, Bratislava 2012, p. 730.

[8] M. Patyaková in: M. Patyaková a kol., *Obchodný zákonník. Komentár*, Bratislava 2010, p. 467.

[9] Cf. W. Popiołek in: J.A. Strzępka (red.), *Kodeks spółek handlowych. Komentarz*, Warszawa 2015, p. 823.



It seems that an obligation to keep a register of shares does not rise before the registration of a company. In this period the Polish joint-stock company cannot issue any share certificate and it should be noted that pursuant to the Art. 16 of the Polish CCC any disposition of the share made in this period shall be invalid. Because of that, this obligation arises only after the registration of a company. However, the problem is – has the issue of the registered shares and temporary certificates a pivotal importance? These persons that support this view are basing on logical reasoning. The basis of their statement is a fact that when registered share or temporary certificate did not issue the share register will not have any entry. Accordingly, the representatives of this opinion find that there is no obligation to keep a register of shares. This argument has own logical ground. On the other hand, it should be also emphasized that a literal interpretation of mentioned provision of Art. 341 § 1 of the Polish CCC leads to assertion that an obligation to keep the share register does not depend on issuing of a share certificate. Pursuant to the Art. 334 § 2 of the Polish CCC, each of shareholder can demand a change of registered shares, which he possess, into bearer shares. The keeping of the share register in this case can sort out the problem of its creating in the future. According to that, we must admit to these authors which find that the share register shall be set immediately after the registration of a company.

The obligation to keep a register of shares lies essentially on the management board. However, under the Art. 342 of the Polish CCC there is an alternative possibility to commission a bank or investment company in the Republic of Poland to keep the share register. Competence of these entities is exclusive. Neither statutes nor resolution of the general assembly cannot give right to keep the share register to other body of a company (e.g. supervisory board)[10].

## Particulars registered in the share register

The register of registered shares and temporary certificates is kept by joint-stock company and shall not be kept personally as for share-

[10] See: R. Pabis in: Z. Jara, *Kodeks spółek handlowych. Komentarz*, Warszawa 2014, p. 1293–1294.

holders which have registered shares and also for possessors of temporary certificates[11]. According to that, the share register shall state for each share the separate fields to make entries. That can cause some technical problems when there is a lot of shares in joint-stock company, but under the wording of Art. 341 § 1 of the Polish CCC it is the only permissible possibility. The solution to this problem can be the possibility to keep a share register in electronic form, which was stipulated by provision of Art. 341 § 8 of The Polish CCC. One should accede to the statement that fields to make entries can be created for collective share certificates, because any entry will relate to each share which is involved by this collective share certificate[12]. If collective share certificate will be change to smaller, another fields to entries should be also created.

The Polish legislator stipulated in Art. 341 § 1 and § 2 of the CCC particulars that shall be registered in the share register. Pursuant to these provisions in share register shall be registered:

1) surname and first name or business name of shareholder
2) the seat and the address of shareholder or correspondence address
3) the payments made on shares
4) information on the transfer of share to another person, together with the date of registration
5) information on the creation of limited right *in rem* on the share
6) information that pledgee or usufructuary are authorized to exercise the voting right.

It should be noted that Art. 341 § 1 and § 2 of the CCC shall apply accordingly to the pledgee or the usufructuary. It means that the same particulars as in the case of shareholder shall be disclosed in the share register when it comes about the usufructuary (surname, first name, business name and the seat, address or correspondence address).

None of the joint-stock company's documents cannot reduce those particulars that are entered into the share book. It is questionable whether can the scope of data in share book be extended. Art. 341 of Polish CCC does not essentially permit to conceptualize in statutes of company the content of the share book. In our opinion supplementary particulars can be allowed exceptionally by virtue of transparency of the relations between shareholders and company and also between shareholders themselves. An information about exposing in share book other supplementary particulars then these of them which are mentioned in Art. 341 § 1 and 2 of the Polish CCC shall be placed e.g. in statutes of the joint-stock company.

[11] See: T. Siemiątkowski, R. Potrzeszcz in: T. Siemiątkowski, R. Potrzeszcz, *Kodeks spółek handlowych. Komentarz*, Warszawa 2012, p. 261.

[12] Ibidem.



A corresponding regulation to Art. 341 § 1 and 2 of the Polish CCC was placed in § 264 sec. 2 of the Czech Commercial Companies Act. Under this provision the following shall be recorded in the register of shareholders: type of share, its par value, name and place of residence or registered office of the shareholder, number of a bank account held with an entity authorized to provide bank services in a country which is a full member of the Organization for Economic Co-operation and Development, share marking and any changes in the data recorded. Some of representatives of the Czech doctrine emphasize that every shareholder must have a bank account held at least with one of the member state of the OECD[13].

The Slovak legislator marks directly in § 156 sec. 2 of Commercial Code these of particulars which should be recorded in a register of shareholders. Pursuant to this Article, the following data shall enter to register of shareholders: classification number of share, type of share, its nominal value, and, if the shareholder is a legal entity, its commercial name or designation and its seat and, if the shareholder is a natural person, his name and surname, residential address and the identification number. The Slovak authors highlight that, there is no classification number for registered share, because they are recorded directly onto appropriate securities account which is held for the joint-stock company and in appropriate field of one particular shareholder appear an information of the overall number of shares which appertain to this shareholder in the joint-stock company[14]. Interestingly, the Slovak legislator provided in § 768b sec. 3 of the Commercial Code a specific sanction, if a company did not carry out its duties on entering particulars into the register of shareholders. Pursuant to

[13] See: I. Štenglová in: I. Štenglová, B. Havel, F. Cileček, P. Kuhn, P. Šuk, *Zákon o obchodních korporacích. Komentár*, Praha 2013, p. 458.

[14] L. Žitnaňská in: O. Ovečková a kol., *Obchodný zákonník. Komentár*, Bratislava 2012, p. 730.

this Article, a joint-stock company which issued registered shares (materialized), is on duty to guarantee that a register of shareholders shall include the particulars mentioned in § 156 sec. 6 and is obliged to pass a register to the Central Securities Depository of the Slovak Republic. If a company does not satisfy this obligation, a court will order that a company must be liquidated without request to complete a documentation.

## Access to the share register

There is no doubt that the share register is an internal document of joint-stock company. In Polish law an obligation to keep this register lies basically on management board of a company, but pursuant to the Art. 342 of the CCC there is a possibility to commission a bank or investment company in the Republic of Poland this obligation. Regardless of the subject that keeps a share register, the question arises: which of persons are entitled to inspect the share register?

The every member of the management board as a subject liable for keeping this act has an access to them *ex officio* pursuant to Art. 341 § 1 of the Polish CCC. The Polish legislator provides that under Art. 341 § 7 each shareholder may inspect the share register and request excerpts and the costs of such excerpts to be paid by shareholder. The term "shareholder" should be widely understood, because in our opinion it does not only relate to a person who has possession of registered share or bearer share, but also to a person who has possession of temporary certificate. This right cannot be limited or excluded by statutes of the company[15].

The literal interpretation of the Art. 341 § 7 of the CCC leads to conclusion that the share register may be inspected only by shareholder, but not by a pledgee or an usufructuary, which are also indicated in this register. Although this statement is presented in Polish doctrine[16], it seems that it is too stringent, because persons who

[15] Cf. A. Opalski in: A. Opalski (red.), *Kodeks spółek handlowych. Tom IIIa. Spółka akcyjna. Komentarz – art. 301–392*, Warszawa 2016, p. 827.

[16] See: W. Popiołek in: J.A. Strzępka (red.), *Kodeks spółek handlowych. Komentarz*, Warszawa 2015, p. 826.



are entitled by a limited right *in rem* on the share (e.g. a pledgee) are excluded from a circle of authorized persons. The functional interpretation should have a priority in our opinion, because without any corresponding right for a pledge or usufructuary these persons cannot exercise their rights as: voting right, right to disclosure a limited right *in rem* on the share (Art. 341 § 2 of the CCC) or right to lodge an objection (Art. 341 § 4 of the CCC)[17].

Furthermore, it must be accepted that the circle of authorized persons, who have a right to inspect a share register, concerns also third parties which have a legal interest to inspect a share register[18]. Here is about investors that are interested in purchase shares of the particular company and want to participate in its business activity. This approach enables to keep to a minimum a legal risk interrelated not only with dealing with shares but also with temporary certificates. The Polish legislator did not use in Art. 341 § 7 of the CCC a word "only". Thusly the wording of this provision does not determine an excluded circle of persons authorized to inspect a share register and request excerpts. Otherwise the stringent interpretation can lead to absurdity, because no one, besides shareholder (neither a member of the management board nor a person entitled by a limited right *in rem* on the share), will not have the right to inspect a share register. Even the management board would not have a possibility to verify entries with respect to the formal correctness.

There arises the question, if the member of supervisory board has the right to inspect share register. Due to the fact that this body exercise permanent supervision over organizational activities of the management board, we must accede that the members of the supervisory board do have the right to inspect a share register. Under the provision of Art. 382 § 1 of the CCC, supervisory board shall exercise permanent supervision over all areas of the activities of the company and also – pursuant to Art. 382 § 4 – in order to perform its duties "may review all documents of the company".

[17] See more: S. Sołtysiński, M. Mataczyński in: S. Sołtysiński, A. Szajkowski, A. Szumański, J. Szwaja, A. Herbet, M. Mataczyński, I.B. Mika, T. Sójka, M. Tarska, M. Wyrwiński, *Kodeks spółek handlowych. Tom. III. Spółka akcyjna. Komentarz do art. 301–490*, Warszawa 2013, p. 346.

[18] See: A. Opalski in: A. Opalski (red.), *Kodeks spółek handlowych. Tom IIIa. Spółka akcyjna. Komentarz – art. 301–392*, Warszawa 2016, p. 828.

When it comes to the circle of persons authorized to inspect a share register, the Czech legal doctrine is much more stringent than Polish. According to the § 266 sec. 1 of the Commercial Companies Act, a copy of the list of shareholders who own registered shares or of a requested part of that list shall be issued by a company to any of its shareholders at his written request and his expense, without undue delay after the receipt of such request. Furthermore, the bank account numbers recorded in the list shall only be provided by a company to the persons provided for in an act governing business transaction on the capital market or to any person with the consent of shareholder concerned by the records. § 115 of the above mentioned act stipulates that the joint-stock company is obliged to give this information to: court for judicial proceedings; bailiff for executive proceedings in which shareholder is participant; authorities which operate in criminal proceedings (e.g. prosecutor); tax authorities for tax proceedings and the Czech National Bank for control of the financial market or for the running of the banking information system; trustee in bankruptcy for bankruptcy proceedings and to other authorities mentioned in this provision[19].

If the Czech doctrine seems stringent when it is about persons authorized to inspect the share book, then the Slovak legislation is even more intransigent. § 156 sec. 6 of the Commercial Code provides in 5th sentence that the book of shareholders is not public[20]. The Slovak doctrine is of the opinion that none of the third persons does not have the right to inspect the register of shareholders. Besides, even a shareholder has the right to inspect the register of shareholders only with regard to information that concerns his position in the company[21]. The obligation to classify the data recorded in the register of shareholders lies on the Central Securities Depository of the Slovak Republic. When shareholder requests excerpt (copy) from the register of shareholders, he will be obliged to pay cost of such excerpt[22].

[19] Cf. I. Štenglová in: I. Štenglová, B. Havel, F. Cileček, P. Kuhn, P. Šuk, *Zákon o obchodních korporacích. Komentár*, Praha 2013, p. 460.

[20] Slovak, Zoznam akcionárov nie je verejný.

[21] Cf. L. Žitnaňská in: O. Ovečková a kol., *Obchodný zákonník. Komentár*, Bratislava 2012, p. 730–731; M. Patyaková in: M. Patyaková a kol., *Obchodný zákonník. Komentár*, Bratislava 2010, p. 467.

[22] See: L. Žitnaňská in: O. Ovečková a kol., *Obchodný zákonník. Komentár*, Bratislava 2012, p. 731.



## The legal character of the entry in the share register

There is no accordance to the legal character of entry in the share register and its legal effects in the Polish legal literature. In the doctrine prevails a view that entry has a declaratory effect[23]. In accordance with this point of view, an entry of any information into the share register is not a condition of the establishment of the membership in a company. It creates only a legal presumption that a shareholder registered in the share register has a substantive entitlement. This presumption can be rebutted by proof that a shareholder registered in the share register does not have rights mentioned in a registered share. In other words, an entry into the share book shall be treated as a necessary premise to exercise rights arising from the share. The representatives of this statement testify that reverse thesis does not have any base in wording of Art. 354 § 1 of the CCC[24]. This provision subordinates only an establishment of formal entitlement, but not an acquisition of substantive right to an entry in the share register. This statement was presented in judicature[25], but there are also judgments stipulated a different character of an entry[26].

On the other hand, there is also a group of authors that declaims a constitutive effect of entries into a share register[27]. In their opinion, the transferor is a shareholder until the moment when a transferee will be registered into a share register. The constitutive character of the entry concerns not only relation between a company and transferee, but also third parties. A justification for this statement is that the declaratory character of the entry in the share register can make

[23] A. Kidyba, *Kodeks spółek handlowych. Komentarz T. II, Komentarz do art. 301–633*, Warszawa 2010, p. 252; A. Opalski in: S. Sołtysiński (red.), *System Prawa Prywatnego*, t. 17B, *Prawo spółek kapitałowych*, Warszawa 2010, p. 276–279; Z. Opałko, *Księga udziałów i księga akcyjna w spółkach kapitałowych*, "Prawo spółek" 1999, Nr 10, p. 23; G. Wolak, *Charakter prawny i skutki wpisu do księgi akcyjnej*, "Prawo spółek" 2011, Nr 7–8, p. 84 et seq.

[24] See. A. Opalski in: S. Sołtysiński (red.), *System Prawa Prywatnego*, t. 17B, *Prawo spółek kapitałowych*, Warszawa 2010, p. 277.

[25] See: Judgement of The Supreme Court of Poland on 4.12.2009, III CKS 85/09, BSN 2010, Nr 3, p. 13.

[26] See: Judgement of The Supreme Court of Poland on 3.7.2003, III CKN 309/01, OSN 2004, Nr 9, p. 148.

[27] T. Siemiątkowski, R. Potrzeszcz in: T. Siemiątkowski, R. Potrzeszcz, *Kodeks spółek handlowych. Komentarz*, Warszawa 2012, p. 268–271.

a nonsense of the legal institution of a share register and can make also that shares would be transfer unbeknown to a company. As a consequence it could coapt the registered shares to bearer shares and make difficult for a company an identification of authorized persons.

It is worth noting that in the Polish legal literature is also presented third statement. According to that an entry in the share book has the constitutive effect when it comes to treating by a company this person which possess a share as a shareholder. The constitutive effects concerns only relation between a company and transferee of the share. An entry in the share register is necessary for the exercising the rights in a company, but it does not create different base for establishment of substantive rights.

Some circumstances must be pointed out in addition to the above mentioned remarks and for entertaining a proper statement. Firstly, the thesis about constitutive effects of the entry in the share register as a premise to receive a member's status in joint-stock company when a shareholder purchased a registered shares has no justification under wording of Art. 343 §1 of the CCC. In this provision was used an utterance "in relations with the company, only a person who is registered in the share register [...] shall be deemed a shareholder". The words "shall be deemed" (Pol. uważa się) have to be understood as rebuttable presumption of law[28]. It means that formal entitlement does not appertain to the possessor of registered shares, but to the person who is registered in the share register. According to that, a register in a share register does not have any influence on transfer a share between parties of the legal act, because a transferee of a share may sell his share before a registration in a share register. In this case as a shareholder will be considered this person who is registered in the share register[29]. With regard to above mentioned remark, a register in the share register shall not be deemed as a effective condition of the transfer a share to the third parties anyway. The share book is an internal act of a company and its main task is to

[28] Cf. W. Wyrzykowski, *Nawiązanie stosunku członkostwa w spółce akcyjnej*, [in:] J. Olszewski (red.), *Tendencje reformatorskie w prawie handlowym. Między teorią a praktyką*, Warszawa 2015, C.H. Beck, p. 265–266.

[29] See: T. Kunicki, *Wpis do księgi akcyjnej a uzyskanie legitymacji formalnej i materialne z akcji imiennej*, "Prawo Spółek" 2009, Nr 9, p. 55 et seq.



show a rights indicated in documents not substantive rights of shareholders at all[30].

Secondly, in the case of taking a view that an entry has a constitutive effect in relation to a company and also to the third parties, an effective register in a share register must be achieved for the transfer of rights issued from the registered share. This statement is contrary to Art. 339 of the CCC. In accordance with wording of this provision, the transfer of the registered share "shall be effected by way of a written declaration either in the share certificate [...] or in a separate document and shall require the transfer of possession of the share". This provision does not dictate making any other acts to the parties of a transfer of a share agreement. The transferee receives a status of a shareholder either at the moment of transfer of rights issued from the share that takes place at the moment of ceding a document of share in the case of the bearer share or at the moment of the transfer of possession of the share in the case of the registered share.

Thirdly, these of authors that find constitutive effect of the entry emphasize that necessary premise for receiving a status of a shareholder in a company (register in a share register) will be not required when one of shareholders died[31]. It is hard to defend a statement that a deceased person is still a shareholder. In our opinion, there is no reason to consider that the moment of receiving a status of a member of a company in case of legal acts *inter vivos* is different than in the case of legal acts *mortis causa*.

Fourthly, Art. 341 of the CCC does not appoint a term in which a management board shall register the new shareholder in the share register. Pursuant to Art. 341 § 4 of the CCC, before any entries in the share register are altered, the management board shall announce its intention to concerned persons and designate at least a two-week deadline for lodging objections. The term may be longer. On the

[30] Cf. W. Wyrzykowski, *Nawiązanie stosunku członkostwa w spółce akcyjnej*, [in:] J. Olszewski (red.), *Tendencje reformatorskie w prawie handlowym. Między teorią a praktyką*, Warszawa 2015, C.H. Beck, p. 266 and. A. Opalski in: S. Sołtysiński (red.), *System Prawa Prywatnego*, t. 17B, *Prawo spółek kapitałowych*, Warszawa 2010, p. 276.

[31] See: T. Siemiątkowski, R. Potrzeszcz in: T. Siemiątkowski, R. Potrzeszcz, *Kodeks spółek handlowych. Komentarz*, Warszawa 2012, p. 271.

assumption that the entry has an constitutive effect, the management board can manipulate this term and even freeze a making an entry[32].

The Czech legislator in § 265 sec. 1 of the Commercial Companies Act provided an rebuttable presumption of person who is treated as the owner of the registered shares. Under this provision – in relations with the company, a shareholder is presumed to be any person registered in the register of shareholders. It is emphasized in that doctrine that if an owner of the registered share was not registered in the register of shareholders, he shall circumstantiate to the company before that he is a real owner of this registered share which gives him a possibility to exercise his rights in a company[33]. If a shareholder was entitled to exercise his voting right on the general assembly of the company, but he could not vote due to the fact that he was not register in the register of shareholders, this shareholder has right to bring an action against company for a declaration of the invalidity of a resolution of the general assembly[34].

In the Slovak law, in accordance with wording of third sentence of § 156 sec. 6 of the Commercial Code – the rights concerning the registered shares can be exercised in relations to a company by a person registered in the share register. It is emphasized in the Slovak legal literature that a register of a shareholder into the register of shareholders has a crucial character, when it comes to exercise shareholder's rights in relation to the company[35]. There is also mentioned that it is a break of the rule under which the rights of shareholder as a member of a company are related to acquire a share.

[32] See more: W. Wyrzykowski, *Nawiązanie stosunku członkostwa w spółce akcyjnej*, [in:] J. Olszewski (red.), *Tendencje reformatorskie w prawie handlowym. Między teorią a praktyką*, Warszawa 2015, C.H. Beck, p. 267.

[33] I. Štenglová in: I. Štenglová, B. Havel, F. Cileček, P. Kuhn, P. Šuk, *Zákon o obchodních korporacích. Komentár*, Praha 2013, p. 459.

[34] See: I. Štenglová in: ibidem.

[35] See: L. Žitnaňská in: O. Ovečková a kol., *Obchodný zákonník. Komentár*, Bratislava 2012, p. 730.



## Conclusion

In the summery of foregoing contemplations must be drawn the following conclusions. The share register in the Polish law is an internal document keeping by management board of the joint-stock company. The access to this register may be allowed not only to the shareholders, but also to these subjects which have legal interest to inspect it. These subjects can be also members of the bodies of joint-stock company. It should be emphasized that the share book has a great importance for the formal entitlement of the possessors of registered shares or temporary certificates to act in a company. Likewise, an entry to share book does not create new legal relationship and has no influence on the establishment of the membership in a company. Entries in a share book are only rebuttable presumptions which indicate that person mentioned in the register shall be deemed a shareholder and can exercise his rights in a company.

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# THE OBLIGATION TO CONTRIBUTE TO THE LIMITED LIABILITY COMPANIES CREATED ON THE BASIS OF A MODEL DEED

## Introduction

The Polish Code of Commercial Partnerships and Companies (CCPC)[1] provides for the establishment of a registered partnership, limited partnership and a limited liability company with the use of model deeds. In relation to a limited liability company, such a possibility was introduced to the Code for the first time as a result of an amendment to the CCPC introduced by the Act of 01.04.2011[2]. The next amendment made by the Act of 28.11.2014[3] added a definition of a partnership and company created on the basis of a model deed to the Code. This amendment also made a number of additional provisions allowing partnerships and companies to do a number of other activities based on other standard forms, e.g. models of resolutions amending the articles of association of a limited liability company and other resolutions; a resolution appointing a holder of commercial power of attorney.

Art. 4 § 1 point 15 specifies the definition of a partnership or company whose articles of association were executed using model articles

[1] Ustawa z 15.09.2000 r. – Kodeks spółek handlowych, consolidated text Dz.U. 2013.1030 as amended.

[2] Ustawa z 1.04.2011 r. o zmianie ustawy – Kodeks spółek handlowych oraz niektórych innych ustaw, Dz.U. z 2011 r. Nr 92, p. 531.

[3] Ustawa z 28.11.2014 r. o zmianie ustawy – Kodeks spółek handlowych oraz niektórych innych ustaw, Dz.U. 2015 p. 4.



of association. Following this article: a partnership or company whose articles of association were executed using model articles of association apart from a company or partnership formed using the model whose articles of association were amended other than using the model. Due to the extremely long and complicated definition which the legislator used to determine companies created on the basis of model deeds, it is proposed in the scholarly literature to use the term e-partnerships or e-company[4].

The new provisions lead, basically, to identify, within the regulations of the Code of Commercial Partnerships and Companies, a new subtype of a limited liability company[5]. The specificity of an e-company manifests itself both in the specific terms of its formation and in terms of its functioning. In case of e-companies, a notarial form of the articles of association is not required to the advantage of using standard forms of articles of association concluded through the IT data transmission system. In these companies only cash contributions shall be made to cover their share capital. At the same time, the principle of full coverage of the share capital prior to the registration of such e-companies was excluded.

The aim of this paper is to analyze the obligation to contribute to the e-companies and the possible consequences of non-performance of this obligation. This issue is so important precisely because in these companies the legislator decided to introduce an exception to the principle of full coverage of the share capital. The literature emphasizes, at the same time, that the specific regulations of the Code of Commercial Partnerships and Companies (CCPC) on creating e-companies lead to a decrease in the standard of legal certainty and breach of the security of trading[6].

[4] See: W. Popiołek, *Czy koniec osiemdziesięcioletniej tradycji formy niektórych czynności prawa spółek?*, „Przegląd Prawa Handlowego" 4/2015, p. 51.

[5] See: A. Szumański, *Nowelizacja kodeksu spółek handlowych z 28.11.2014 r. przewidująca szersze wykorzystanie wzorca udostępnianego w systemie teleinformatycznym*, „Przegląd Prawa Handlowego" 4/2015, p. 41.

[6] See: W. Popiołek, *Czy koniec...*, op. cit., s. 54; A. Szumański, *Nowelizacja...*, op. cit., p. 38; M. Łeśniak, *Normatywny wzorzec umowy spółki z o.o. – ocena kierunku zmian przepisów kodeksu spółek handlowych*, [w:] *Instytucje prawa handlowego w przyszłym kodeksie cywilnym*, red. T. Mróz, M. Stec, Warszawa 2012, p. 672; Idem, *Spółka z o.o. zakładana za pomocą wzorca umowy – nowelizacja kodeksu spółek handlowych*, „Przegląd Prawa Handlowego" 12/2011, p. 35–42; Ł. Zamojski, *Uwagi na tle projektu „S24" dotyczące-*

## Establishment of a limited liability e-company

The execution of articles of association is done in the IT system which has been defined in § 2 point 1 of the Ministry of Justice's order of 22.03.2016[7], using the model of articles of association. This legal act defines in detail the principles of setting up an account in the system and taking actions in it using various standard forms. During the procedure of executing articles of association on the basis of a standard form, several basic steps can be distinguished:
1) establishing a user account;
2) filling-in an electronic standard form of articles of association;
3) signing of the articles of association.

A user account shall be established by all natural persons who will be involved in taking action on the basis of the standard form. Creating an account in the system requires introducing personal data specified by the Minister of Justice in the order. Next, the user should develop the name and password. The creation of the account in the IT system is only possible after verification of the full name and the PESEL number in comparison with the PESEL system data base[8]. The main drawback of the solution is the lack of adequate verification of the actual person opening the account. In practice, there are cases of setting up user accounts and then establishing e-companies by individuals who only use other people's personal data.

The next step is to start to fill out standard articles of association of a limited liability company, and thus to determine the content of the articles of association or deed of incorporation executed by the sole shareholders of an e-company. The conclusion of the articles of association on the basis of the model of articles of association occurs

*go przyspieszonej rejestracji spółek z o.o.*, „Prawo Spółek" 2/ 2011, p. 21–27; A. Malareiwicz-Jakubów, E. Bieniek-Koronkiewicz, R.R. Tanajewska, *Wzorzec umowy spółki z o.o. udostępniony w systemie teleinformatycznym*, [w:] *Kodeks spółek handlowych po dziesięciu latach*, red. J. Frąckowiak, Wrocław 2013, p. 412–413.

[7] Rozporządzenie Ministra Sprawiedliwości z 22.03.2016 r. w sprawie trybu zakładania konta w systemie teleinformatycznym, sposobu korzystania z systemu teleinformatycznego i podejmowania w nim czynności związanych z zawiązaniem spółki z ograniczoną odpowiedzialnością przy wykorzystaniu wzorca umowy oraz wymagań dotyczących podpisu elektronicznego, Dz.U. 2016.420.

[8] Powszechnym Elektronicznym Systemie Ewidencji Ludności (PESEL); i.e. Polish personal identification number.



upon the introduction of all the necessary data and submission of an electronic signature.

Among the particularly criticized solutions for creating a limited liability e-company is the possibility to express a declaration on the conclusion of the articles of association by means of using an electronic signature which is associated with the ICT system through the user account[9]. It should be emphasized that only with regard to a limited liability e-company, the regulation of Art. 157 § 3 of the CCPC assumes that the articles of association require an electronic signature without clarifying the requirements for the signature itself. In other cases, the legislator expressly states that the conclusion of a registered e-company and a limited liability e-partnership requires a secure electronic signature verified using a valid qualified certificate or a signature confirmed by a trusted e-PUAP profile (Art. 323 § 3 of the CCPC and Art. 106 § 3 of the CCPC). The question of how to sign articles of association of a limited liability company was clarified only in the act by the Minister of Justice of 22.03.2016, where § 9 section 1 indicates that the electronic signature shall be submitted by introducing a user name and password. At the same time, section 2 of this provision allows to sign articles of associations and other documents by using a safe electronic signature verified using a valid qualified certificate or a signature confirmed by a trusted e-PUAP profile. The adoption of the solutions is insofar misconceived as they waive the requirement of a notarial deed for the articles of association of an e-company, and at the same time allow for the conclusion of the articles of association by using electronic signature that does not meet the appropriate standards for verification of the person submitting the declaration of intent. This, in turn, causes a weakening of safety and security of trade.

The request for entry of a company formed by using the model made available in the ICT system takes place in the electronic form. The deadline to request a registration of a limited liability e-company, unlike in case of companies set up in the traditional way, is seven days from the date of conclusion of the articles of association of the

[9] See: Ł. Goździszek, *Umowa spółki z o.o. zawierana przy wykorzystaniu wzorca i postać wniosku o wpis do rejestru*, „Przegląd Prawa Handlowego" 8/2012, p. 37; W. Popiołek, *Czy koniec...*, op. cit., p. 54; A. Szumański, *Nowelizacja...*, op. cit., p. 38; M. Leśniak, *Spółka z o.o. ...*, op. cit., p. 35–42; Ł. Zamojski, *Uwagi...*, op. cit., p. 21–27; A. Malareiwcz-Jakubów, E. Bieniek-Koronkiewicz, R.R. Tanajewska, *Wzorzec umowy...*, op. cit., p. 412–413.

company. Ineffective expiry of the term means the articles of association shall be terminated, and an e-company in organization should be liquidated under Art. 170 of the CCPC.

## A special e-company regulation in terms of contributions of shareholders

In e-companies it is impossible to make in-kind contributions. After creating an e-company, it is possible to increase the share capital in the traditional way, where there are impediments for contributions in-kind. However, this will lead to the final loss of the status of an e-company.

As part of a special normalization of a limited liability e-company, there has been introduced an exception to the time within which contributions are to be paid. According to Art. 158 § 3 sentence 2 of the CCPC, covering the share capital in these companies should take place no later than 7 days from the company's registration. This is an important exception to the principle of full coverage of the share capital of limited liability companies prior to the registration of the company with limited liability. At the stage of creating an e-company, shareholders are allowed to choose from two options. Shareholders concluding the articles of association may decide to bring the contributions before the registration of an e-company. In contrast to the joint-stock company, which requires payments in cash to the bank account of the joint stock company in the organization (Art. 315 § 1 of the CCPC), in limited liability companies there are no restrictions. In principle, there are no obstacles for an e-company in organisation to open a bank account to which the shareholders shall pay by way of making contributions. An e-company in organization arises upon conclusion of the articles of association in the ICT system. Just like a company created in the traditional way, an e-company in organisation has the legal capacity, however, is not a legal person. Due to the fact that pursuant to § 15 of the standard articles of association the company board is appointed simultaneously with the conclusion of the articles of association of the company, a limited liability e-company in organization on concluding a bank account agreement is represented by the board. Because in case of limited liability companies there is no obligation to make payments to the bank account of the company, it is permissible to also make payments directly to members of the board who, after registration of the company open a bank account and make appropriate payments.



If the shareholders make contributions before the registration of the company as a whole, all members of the board make a statement in the court of registry in accordance with Art. 167 § 4 section 3 of the CCPC, like in case of a company created the traditional way, confirming that contributions were made in full by all the shareholders. The Polish regulation of limited liability companies does not provide for judicial control over making contributions, while Art. 291 of CCPC introduces an extremely strict responsibility of board members for making a false declaration. According to the Art. 291 of the CCPC, where members of the management board provided, intentionally or negligently, false information in the statements referred to in Art. 167 § 1 (2) or Art. 262 § 2 (3) CCPC, they shall be liable towards the company's creditors jointly and severally with the company for a period of three years following the registration of the company or registration of an increase in the share capital. It is important that introducing an e-company to the Code, the legislator amended Art. 167 of the CCPC, but did not make an adequate reformulation of Art. 291 of the CCPC, which is the subject of justified criticism in the literature[10]. As a result, Art. 291 CCPC leads to a difficult to accept conclusion while in companies traditionally set up, the members of the board will be accountable for making a false statement, in an e-company such responsibility does not exist. The thesis that despite the wording of Art. 291 of the CCPC, it also applies to statements made by members of the board of e-companies, can be justified by the *ratio legis* of Art. 291 of the CCPC. However, it is difficult not to notice that equally successfully can be formulated arguments against basing the strict liability of Art. 291 of the CCPC only on directives of teleological interpretation. There is no doubt, however, that making a false statement in both companies traditionally set up and in e-companies

[10] See: E. Zielińska, J.A. Strzępka, [w:] *Kodeks spółek handlowych. Komentarz*, red. J.A. Strzępka, Warszawa 2015, p. 423; A. Szumański, *Nowelizacja...*, op. cit., p. 38.

falls under criminal offense of Art. 587 of the CCPC, and hence the board members bear criminal liability.

As mentioned above, e-companies with limited liability exceptionally allow to make contributions after the registration of the company. According to Art. 167 § 5 of the CCPC, the company's board should within 7 days of registration declare that cash contributions to the share capital have been fully paid. A fundamental problem occurs when a partner fails to contribute.

According to Art. 206 § 1 section 4 of the CCPC in the company's letters and commercial orders submitted by a limited liability company in printed or electronic form, the board should inform that the required contributions to the share capital have not been made. Lack of inclusion of relevant information in accordance with Art. 206 § 1 of the CCPC may entail a penalty in the form of a fine of up to 5000 PLN laid down in Art. 595 of the CCPC. In addition to the requirement to provide such information by the board of the company, also in accordance with Art. 38 section 8 f of the National Court Register Act[11], there is an entry added saying that the capital has not been covered. In fact, immediately after the expiry of 7 days from the registration of the company, the board should take actions in order to cover the share capital. However, the instruments available to the board are limited. First of all, the board may exert the performance of the obligation to contribute. In connection with the wording of Art. 228 section 2 of the CCPC, in this case it is not necessary to take a resolution of shareholders. Claiming in court the performance of an obligation to contribute, however, requires time in which the registered company will not have covered the share capital and, in many cases, will lack funds to operate. Therefore, other alternatives should be considered in situations where the remaining shareholders are willing to further maintain the existence of the company. The simplest solution in this case is the purchase of shares not covered for and performing the obligation to contribute by the purchaser. Some other way to ensure coverage of the share capital in an e-company may be redemption of shares belonging to a shareholder who did not perform the obligation to contribute. However, this requires the fulfilment of several conditions. Firstly, the articles of association of an e-company must provide for redemption of shares. Voluntary redemption of shares is provided for in one of the variants of § 8 of the standard articles of association. Secondly, voluntary redemption of shares will require consent of the shareholder whose participation is discontinued. Thirdly, if the company's share capital is reduced through redemption of shares below the minimum value, it is necessary to simultaneously increase it. In this case, the new shares would, however, have to be covered by the remaining shareholders or third parties. Redemption of shares, provided that the above conditions are met, seems to be a reasonable and quick solution to the lack of coverage of the share capital. Failure to comply with the obligation to contribute may also constitute grounds for exclusion of a shareholder from a given partnership, but it will be possible only if the other shareholders represent more than half of the share capital. Applying the procedure of excluding a partner seems not to be an effective way of covering the share capital due to the relatively long legal proceedings that are also subject to various terms and conditions.

Lack of will to cooperate between the shareholders of a company as concerns covering the share capital will inevitably lead to the dissolution and liquidation of the company. Therefore, the board should take action to adopt a resolution to dissolve the company. After changes to the Code of Commercial Partnerships and Companies, which entered into force on 01.04.2016, such a resolution may be taken either in the traditional way, i.e. through the shareholders' meeting, which should be recorded by a notary, or using a standard version of such a resolution. Nevertheless, it should be noted that adoption of the resolution on the basis of a model of the resolution requires the vote of all shareholders of the company, as well as to vote using a secure electronic signature verified by means of a qualified certificate or signature confirmed with a trusted e-PUAP profile. If the resolution to dissolve the company is not taken, the board can only demand the dissolution of the company by way of a court sentence on the basis of Art. 271 section 1 of the CCPC. This, however, involves additional costs of both legal proceedings and the liquidation of the company.

[11] Ustawa z dnia 20 sierpnia 1997 r. o Krajowym Rejestrze Sądowym, consolidated text Dz.U. 2016.687.

## Authority of the registry court in case of failure to submit a statement of payment of contributions

Introducing the possibility of creating e-companies in 2012, the legislator did not make at the same time changes in regulations that would allow the registry court to effectively and quickly eliminate companies in which share capital has not been covered. Some instruments that may optionally be used for this purpose were introduced only in the amendment to the Act on the National Court Register made in 2014[12]. In the first instance, the court of registration determining a company's board failure to submit a statement of making contributions to the company by all partners despite the expiry of the deadline, should apply Art. 24 § 1 of the National Registry Court. Acting on the basis of this provision, the court of registration requires board members to make a statement about the payment of contributions, determining at least 7 days' notice, on pain of a fine. It seems that in the event that the board explains failure to perform the obligation to pay contributions by the shareholders it is justified to remit the coercive proceedings under Art. 24§ 4 of Act on the National Registry Court, as it is obvious that further conduct of the proceedings and the imposition of fines on members of the board will not lead to the fulfilment of the obligation. This in turn is a prerequisite for the initiation of proceedings for removal of a company from the commercial registry without conducting winding-up proceedings. It is worth mentioning here that terminating coercive proceedings by the court occurs also in case of complying with the obligation to submit a declaration of contribution payments. For this reason, one should separate the critical comments to the wording of Art. 25 § 1, section 3 of Act on the National Registry Court, which does not leave the court of registration a possibility to withdraw from the initiation of proceedings for the dissolution of the company without liquidation, also in case of termination of coercive proceedings because of the performance of the duties[13]. In the course of proceedings for the dissolution of the company, in accordance with

[12] Ustawa z 28 listopada 2014 r. o zmianie ustawy o Krajowym Rejestrze Sądowym oraz niektórych innych ustaw, Dz.U. 2014.1924.

[13] See: Ł. Zamojski, *Nowelizacja ustawy o Krajowym Rejestrze Sądowym w zakresie postępowania przymuszającego*, „Przegląd Prawa Handlowego" 2015/11, p. 54.



Art. 25 a, the court of registration shall investigate whether the company has a transferable property and whether it actually runs a business activity. Therefore, the court shall notify the board of the initiation of proceedings, calling to demonstrate within 14 days that the company actually operates and owns assets. The initiation of proceedings for the dissolution of the company without conducting liquidation proceedings the court shall announce in the Court and Economic Monitor. In a situation where the company has no body authorized to represent it or the address specified in the National Registry Court is no longer valid, such announcement by the court replaces a court notice. During the investigation proceedings, the court may ask tax authorities for information, authorities responsible for registers and records and other administrative bodies.

A finding by the court of registration during the proceedings determining that the company does not have transferable assets and does not actually run a business is the basis for issuing a decision on the dissolution of the company without liquidation proceedings. The ruling to dissolve the company by the court allows for elimination from the market companies listed in the register and, in principle, not conducting any business activity. Among the negative substantive premises preventing issuing a decision to dissolve a company without conducting liquidation is the court's determination that the entity has transferable assets or actually runs a business activity. Determination in the course of proceedings that the e-company, despite the absence of full coverage of the share capital, conducts business or has assets means that the registry court may appoint remedial programme implementation supervisor on the basis of Art. 26, § 1 of the National Registry Court. Only such are medial programme implementation supervisor may take actions in order to liquidate the company.

## Conclusions

Introduction of a limited liability e-company into the Polish legal system constitutes an important facilitation to setting up a business activity. However, specific normative solutions concerning e-companies lead to critical comments. The fundamental problem is the lack of appropriate verification of people setting up companies. Doubts

also raise due to a departure from the principle of full coverage of the share capital prior to the registration of the company, without the simultaneous introduction of instruments that would guarantee such a coverage after the registration. An important drawback to do with the introduced regulations is misleading reference in Art. 291 of the CCPC, which was not changed at the time of introducing the amendment. Hence, there is no certainty if the board members of e-companies who make a false statement concerning paying contributions shall be liable towards the company's creditors jointly and severally with the company. It should be emphasized that in traditional companies it is a key mechanism whose aim it is to ensure coverage of the share capital. The analysis of the act on the National Registry Court leads to the conclusion that the registration court has the necessary means that can lead to the dissolution of an e-company whose share capital has not been fully covered, but this requires conducting a time-consuming procedure. As a result of the introduced changes, there is now a substantially increased risk of conducting a business activity by limited liability companies whose partners have not covered the share capital, but enjoy the benefits of a separate legal personality of the company and the exclusion of liability of the shareholders for the company's liabilities.

# LEGAL ISSUES OF CONTRACTS

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# CONTRACTUAL REGULATION OF USING HUNTING LANDS

## Introduction

Judicial facts is the reason for creating, changing and ending any legal relationships. Relatively, legal relationships of using hunting natural resources can create, change and end on the basis of such judicial facts as actions and events.

Judicial facts as the reason for creating legal relationships of using hunting land are characterized by their complicity. It means that in order to create appropriate legal relationships it is necessary to find several judicial facts, including contracts.

## Formulation of problem

According to the Article 21 (Part 2) of Laws of Ukraine "About hunting economy and hunting"[1], possessing hunted animals and performing hunting economy is not acceptable without having appropriate documents in accordance with this Law. At the same time in this Law there is no exact list of such documents, their requirements and a specific order of their execution.

According to the Article 22 (Part 1) of the given Law, hunting lands for performing hunting economy can be given to use based on the Verhovna Rada's decision in the Autonomous Republic Crimea,

[1] About hunting economy and hunting: law of Ukraine from February 22, 2000, № 1478-III [Electronic resource]. Retrieved June 15, 2016 from: http://zakon4.rada.gov.ua/laws/show/1478-14.

regional, Kyiv and Sevastopol local authorities, which are taken with applying by the central body of executive branch. The latest is responsible for realizing a state policy in forest and hunting economy coordinated with the Council of Ministers in the Autonomous Republic Crimea, regional, Kyiv and Sevastopol local authorities, and also the land owners or users.

Besides, on the basis of regulations (Part 3 and 6 Article 21 the Paw of Ukraine), in the process of giving/receiving hunting lands to use them, making the two contracts is obligatory: 1) the contract about requirements for hunting economy, that is made between the central body of executive branch realizing a state policy in forest and hunting economy and the hunting land users (Part 3 Article 21 the Law of Ukraine); 2) the contract regulating relations between the hunting area owners or users and the hunting land users (Part 6 Article 21 the Law of Ukraine).

## The contract about requirements for hunting economy

Before getting the sense of the contract about requirements for hunting economy it should be mentioned that the Ministry's of forestry in Ukraine decree from December 12th 1996 № 153[2] determines its standard sense.

According to the Standard contract about requirements for hunting economy, such contracts indicate: 1) the place of making the contract; 2) the date of making the contract; 3) parties to the contract.

The contract's most essential requirements:

1. Subject of the contract, which part of it reveals: 1) information of the resolution that let these lands to be used, it means: a) a name of the body to have taken it; b) the date of taking the resolution; c) the number of resolution; d) the hunting land user; e) the final date until the hunting land is permitted to use it; f) the total square of hunting land given to use, indicating the share of forest, field and water-mud land; 2) the land map-sketch and the description of its restrictions given by the hunting land user; 3) information of the amount of animals in the land given to use (from and to exact date).
2. Rights and duties of the parties – there is a list of the hunting land user's and the central body's of executive branch rights and duties. The latest realizes a state policy in forest and hunting economy.
3. Legal liability – predicting consequences of breaking the terms of the contract.

[2] About confirming the Standard contract about the terms of hunting economy: the Ministry's of forestry in Ukraine decree from December 12, 1996, № 153 [Electronic resource]. Retrieved June 15, 2016: http://zakon2.rada.gov.ua/laws/show/z0735-96.



V.V. Ovdiyenko mentioned straightly that in spite of the significant value of the contract about hunting economy, its standard form has been remaining constant for rather a long time. The matter, that this resolution had been adopted and published several years before adopting the current Law of Ukraine "About hunting economy and hunting", indicates the obsolescence of acting Standard law and its discordance with up-to-date hunting economy laws. Therefore, one of the current issues of legal regulation at Institute of hunting is to design and confirm necessarily a new Standard law about the terms of hunting economy that should meet the current laws' requirements[3].

As for legacy of the contract about the terms of hunting economy, scientists express various ideas. On H.I. Zaychuk's opinion, such contract is the one about using animal world objects[4], and wild animals, which are the part of animal world, are suggested to observe as the rented objects[5]. O.O. Tomyn[6], O.V. Sakal'[7] consider it necessary to broaden the rent form of using hunting land, and they name it as a contract of hunting land renting. At the same time N.R. Kobetska[8],

[3] V.V. Ovdiyenko, *Legacy of hunting in Ukraine: thesis for the degree of Doctor of Law: speciality 12.00.06, Land law; agrarian law; environmental law; nature and resource law*, Kharkiv 2014, p. 95.

[4] H.I. Zaychuk, *Legacy of protection and using animal world: abstract to thesis for the degree of Doctor of Law: speciality 12.00.06, Land law; agrarian law; environmental law; nature and resource law*, Minsk 2001, p. 15.

[5] H.I. Zaychuk in: *Animal world: issues of legal using and protection*, edited by L.N. Moroz, Minsk 2003, p. 58.

[6] O.O. Tomyn, *The Legal adjusting of hunt in Ukraine (on materials of region of Carpathians): abstract to thesis for the degree of Doctor of Law, Land law; agrarian law; environmental law; nature and resource law*, Kyiv 2009, p. 10–11.

[7] O.V. Sakal', *Renting lands of the state forest fund: world's experience and the mechanism of valuation*, "Economy regulation mechanism" 2010/4, p. 114.

[8] N.R. Kobetska, *Contracts in relations of using hunting land*, "Law and society" 2014/1–2, p. 101.

V.V. Semkiv[9] confirm that the contract about the terms of hunting economy (the terms of using hunting land) is not the contract of hunting land renting in classical sense, because it tells about using useful properties of particular areas, but not the areas themselves.

In particular, V.V. Semkiv points out that the lawmaker formulating the regulation of the Law of Ukraine "About hunting economy and hunting" determined his position clearly about the fact that using hunting land shouldn't be confused with renting hunting land, because these two different forms of regulating various social relations. In the term of using hunting land one should understand the permission of state bodies for hunting economy. It is regulated by making appropriate contract, primary renting, with the owners or users of particular field or forest areas[10].

In our opinion, using hunting land means hunting land users' activity together with using useful properties of the area surfaces (field, forest areas together with water objects located on them), which are the medium for natural resources in the period of hunting economy performing due to legal facts indicated in Part 3, Part 6 Article 21 and Part 1 Article 22 of the Law of Ukraine "About hunting economy and hunting".

It's necessary to pay much attention to the fact that hunting land, as a rule, are located simultaneously on the field, forest areas and water objects.

Therefore, we have maintained V.V. Semkiv's position that it should unify legally the practice of making contracts about transferring hunting land in use and deriving the common formula of this transferring, in spite of the fact what area (field or forest) is this particular hunting land on[11].

As for water objects, legislature doesn't anticipate "direct" chance of using water objects in the period of hunting economy, which is totally logical, reasonable, and solves a range of problems that could occur as an example for Forest Code of Ukraine. At the same time, in fact, water objects can belong to hunting land. Though, one should

[9] V.V. Semkiv, *Contracts in the matter of using natural resources: legal aspect: thesis for the degree of Doctor of Law: speciality 12.00.03, Civil law and civil process; family law; private international law*, Ivano-Frankivsk 2013, p. 190.

[10] Ibidem, p. 188.

[11] Ibidem, p. 191.



understand that it's possible only under the following requirements: 1) the water object itself is located just on the field or forest area controlled by hunting land; 2) this water object and/or its useful properties are not taken in the period of hunting economy but only perform the territorial function.

Returning to the legacy of the contract about the terms of hunting economy, it should be mentioned that qualification of relations about using hunting land is related to the difficulty of identifying an object of leasing contract, especially hunting land. When we talk about using hunting land in the terms of leasing, it goes saying about using some useful properties of particular areas, but not using the areas themselves. Useful properties of this or that thing can't be an object of leasing contract, because in this way, according to the Civil Law of Ukraine, there can be the thing specified with individual characteristics and this thing preserves its primary look with the repeated use (Article 760)[12].

At the same time, it's common knowledge that a landlord is the owner of the property or his authorized person. In this case, the party of the contract is a central executive body realizing a state policy in forest and hunting economy, where the owner's powers are not delegated. Besides, particular hunting land (considering its square) can be owned or used by several objects, with it, in the term of different forms of ownership[13]. It means that hunting land can be used in the areas owned by different objects or owners, especially landlords[14].

Thus, we follow the idea that the contract about the terms of hunting economy is a separate type of contract characterized by a special object. It is defined by a subject composition, the prevalence of administrative elements when establishing the tenant's obligations by a special obligatory characteristics resulted from restricted use of hunting land. The contract about the terms of hunting economy has been compiled as individual, taking a particular object into account, to define and confirm the parties' obligations, chiefly to provide a proper condition of hunting land, its preservation, protection and landscaping. It's also worth noting that this contract doesn't have sufficient self-reg-

[12] Ibidem, p. 191.

[13] N.R. Kobetska, op. cit., p. 101.

[14] V.V. Semkiv, op. cit., p. 188.

ulatory values because it's actually based on the decision of the relevant local authority[15].

## The contract regulating relations between owners or landlords and tenants of hunting land

As for the contract regulating relations between the land owners or users and tenants of hunting land, its legal nature is less complicated than the contract about the terms of hunting economy. And one more thing, it connects with the fact that hunting land can be located on the field and forest areas and at the same time forest and field areas. In the matter we have already mentioned, appropriate areas can be of different properties. In this way, it finds out that contracts should be made with each owner or land user in a separate order defined by a specific legislature (but due to practice there can be tens, hundreds and sometimes thousands of persons).

Location of hunting land within field areas of greater number of owners (landlords) makes some difficulties for the tenants of hunting land, especially when getting it in use. In many cases the owners of areas received in the result of land sharing don't use these areas, they have died, are living in other localities, stay abroad; and it's very hard and problematically to get their approval. In particular cases, they don't want to give this approval that results in impossibility of transferring hunting land to the tenant as a single array[16].

Also in this case a question arises about the contract's object – if this land is the one of forest area (and in it accordance, the regulation provides due to the Land code of Ukraine and the Law "About land renting") or forest (in accordance with the Article 18, Forest code of Ukraine). If taking to account traditional way of hunting economy on the forest land, according to the Article 18 of the Forest code of

[15] N.R. Kobetska, op. cit., p. 101.

[16] Legal conclusion about the results of documentary observation given in order to give hunting land in the territory of Balakleya region for Balakleya regional organization in use (dated 02 March 2015) [Electronic version]. Retrieved June 15, 2016: http://www.oblrada.kharkov.ua/uk/news/pravovyy-vysnovok-shchodo-rezultativ-rozhlyadu-dokumentiv-podanyh-z-metoyu-nadannya-10108.html.



Ukraine for hunting needs, forests are transferred to the long-term terminal use[17].

According to the Article 18 (Part 4) of the Forest code of Ukraine, forest of public and municipal properties are transferred to the long-term terminal use on resolutions of relative executive and self-governing bodies. The resolution has been adopted within their powers on the agreement with permanent forest tenants and the executive body on questions of forestry in the Autonomous Republic Crimea, the central executive body providing state policy in the field of forestry. According to the Article 18 (Part 5) of this Code, private properties forests are transferred to the long-term terminal use in the way of making contract between the forests' owner and terminal forest tenant. This contract is the subject to registration in the executive body about the questions of forestry in the Autonomous Republic Crimea, the central executive body providing state policy in the field of forestry. Besides, taking into consideration regulation of the Article 18 (Part 3) of the Forest code, in the first case, after taking appropriate decisions, such contract is also made.

Meanwhile, N.R. Kobetska notifies that in the register of long-term terminal forest contracts located on the site of State Forest Agency in Ukraine there is only one contract, according to which some type of activity has been defined where forest is transferred in use, and it is hunting economy[18].

Therefore, we commonly support V.V. Semkiv's idea to start the process of reforming the field of using hunting land. And it's better to do when excluding word combination *"for hunting economy needs"* from Article 18 (Part 3) and word combination *"hunting land's needs"* from regulation 4 Article 67 (Part 1) of Forest code of Ukraine. Thus, excluding the meaning of renting forest area for hunting economy would be the first step on the way of unification procedure to transfer hunting land in use. This step was caused firstly by the fact that formulating regulations of Forest code of Ukraine, concerning using useful forest properties for hunting economy needs, forces you to think that the field of using hunting land is fully absorbed by the field of forestry, but it's far from true. Moreover, using forest area for

[17] N.R. Kobetska, op. cit., p. 101.

[18] Ibidem.

hunting economy as if "fall out" of the list of forest useful properties given as rented one[19].

And really, when talking about using forest useful properties for hunting economy, the latest have got an economical characteristics. Then, talking about using forest useful properties for cultural retreating, recreative, sport, tourist, educational purposes, it goes about their uneconomical characteristics.

We can agree with the opinion that Article 75 of Forest code of Ukraine that fixes "separateness" of legacy to use forest useful properties for hunting economy, when pointing that this regulation is made according to Forest code of Ukraine, and also Laws of Ukraine "About animal world" and "About hunting economy and hunting", is not quite correct, because, noted not once, using hunting land is not only to use forest useful properties, but also using useful properties of particular ground and water areas paying no attention to their status of field or forest one[20].

To solve the given above problems and to develop the mechanism of giving hunting land in use, the researches give two both possible variations. Each of them, being properly researched, legislatively confirmed and practically realized, deserves existing and can contribute to the development of hunting economy.

The first variation means to create contracts about complex environmental management[21], another one means to establish easements for hunting economy (permanent land easement[22], nature resource easement[23]).

[19] V.V. Semkiv, op. cit., p. 192–193.

[20] Ibidem, p. 193.

[21] Legal system of Ukraine: history, condition and perspectives: [Volume 5] – V. 4: *Methodological background to development of ecological, land, agrarian and business law*, edited by Yu.S. Szemczuszenko, Kharkiv 2008, p. 166; N.R. Kobetska, *Contracts for the use of natural resources*, [in:] *Development of the mechanism of legal regulation of contractual relations in business*, edited by V.V. Luts', Kyiv 2009, p. 268–269; I.S. Shakhraj, *Natural resources as an object of rent right*, [in:] *Law in modern Belarus society: collection of scientific works*, editorial Board: V.I. Siemienkiv (chief editor) and the others, Minsk 2010, p. 414; V.V. Semkiv, op. cit., p. 194–195.

[22] L.D. Neczyporuk, *Ecological legal regulation of rational using animal world's objects: abstract to thesis for the degree of Doctor of Law: spec. 12.00.06, Land law; agrarian law; ecological law; natural resource law*, Kyiv 2009, p. 12; N.R. Kobetska, op. cit., p. 101.

[23] V.V. Semkiv, op. cit., p. 195–196.



## Conclusion

Thus, in contractual regulation using hunting land there are both theoretical and practical problems adversely displayed in the order of giving hunting land in use as a whole.

Solving these problems is possible in the way of developing the existed legally order of giving hunting land in use.

In our opinion, appropriate order must look like the following and be fulfilled gradually: 1) potential user of hunting land apply to the territorial authority of State service in Ukraine on the questions of geodesy, cartography and inventory in order to get a certificate about the fact if there are some areas for hunting economy; 2) if there are some areas for hunting economy, the potential buyer is given the certificate where total area of possible hunting land is noted, together with a part of forest, field and water-bud land and the map-sketch of a possible hunting land, together with indicating its and all the others' restrictions in this land, together with noting its owners and tenants; 3) after this, the potential user of hunting land apply to the owners or/and area tenants to get a permission for hunting economy in their land (in appropriate regulations the owner and/or tenant is noted who gives a permission, the potential user of hunting land, the total area of the land, which concerns to the permission, the periods of permission, general terms that have to be included in the contract later; such permissions can be drawn separately with each owner or tenant, either in the form of a single document, and should be subject to notarization); 4) after getting permissions from the owner and/or tenant of the areas, the potential user of hunting land take these, a map-sketch of a possible hunting land (if any of the owners and/or tenants didn't give this permission, the map-sketch changes according to the given permissions) and the appropriate application to the regional authorities (the Council of Ministers in the Autonomous Republic Crimea, regional, Kyiv and Sevastopol local authorities) to get a permission for hunting land to use (such permissions are drawn in a form of appropriate regulations as for giving the hunting land to use); 5) the potential user applies the representation of getting hunting land in use to the State Agency of Forest resources in Ukraine, and adds the map-sketch of a possible hunting land, the owners' and/or areas tenants' permission, the regional authorities' regulation (the

Council of Ministers in the Autonomous Republic Crimea, regional, Kyiv and Sevastopol local authorities); 6) the potential user of hunting land applies to the regional authorities (the Council of Ministers in the Autonomous Republic Crimea, regional, Kyiv and Sevastopol local authorities) in order to get hunting land in use, addressing the area of this hunting land is located; 7) at the same time the State Agency of forest resources of Ukraine based on the given documents the potential user in addition to these applies presentation about getting hunting land in use; 8) the regional authorities (the Council of Ministers in the Autonomous Republic Crimea, regional, Kyiv and Sevastopol local authorities) take a decision about giving hunting land in use; 9) for a month after taking the decision the State Agency of forest resources of Ukraine and the tenant of hunting land make a contract about the term of hunting economy; 10) for a month after taking the decision the tenant of hunting land makes contracts about establishing natural resource easement with the owners and/or tenants of the areas where there is hunting land.

Besides, at appropriate stages the potential user of hunting land must apply to relative bodies with copies of the certificate about state registration of legal entity, certificates about enrolling in the Unified State Register of enterprises and organizations in Ukraine (it means, about signing mark USREO), incorporation documents. In the case of making legal the possibility of individual person-entrepreneurs to be a tenant of hunting land in the Law of Ukraine, such potential user of hunting land will have to give appropriate bodies the copies of certificates about state registration of individual person-entrepreneurs, passport, individual card of the person-taxpayer.

Actually, just this gradual order of giving hunting land in use is advisable to register in the Article 21, Article 22 of the Law of Ukraine "About hunting economy and hunting".

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# THE MEANING OF SERVICE CONTRACTS IN REFERENCE TO ANIMALS UNDER GERMAN AND POLISH LAW

## Introductory remarks

The legal regulations concerning animals as objects of civil law contracts of various types, in particular regulations of service contracts, do not constitute a popular point of interest among civil law scholars in Europe. Although the sale of animals sometimes appears a topic worthy of further consideration[1], the issue of service contracts with reference to animals is rarely mentioned in the doctrine[2]. However, this topic should be covered, especially as respectively applying provisions concerning movables to animals[3] seems to be problematic[4]. Thus, there are no general rules on how to apply provisions covering

[1] At least under German law, see: J. Adolphsen, Tierkauf in: B. Dauner-Lieb, W. Langen, *BGBSchuldrecht. Nomos Kommentar*, 2012, pp. 1970–1971; J. Eichelberger, *Von neuen und gebrauchtenTieren – ZurAnwendbarkeit des § 475 Abs. 2 BGB auf den Tierkauf*, ZGS 2007, № 98, pp. 98–101; P. Rosbach, *Pferderecht*, München 2011; M. Sommer, *Der Pferdekauf*, Münster/Westfalen 2000; J. Wertenbruch, *Die Besonderheiten des Tierkaufs bei der Sachmängelgewährleistung*, NJW 2012, № 29, pp. 2065–2144.

[2] E. Fellmer, P. Kiel, *Rechtskunde für Pferdehalter und Reiter*, Stuttgart 1984; P. Rosbach, *Pferderecht*, pp. 139–188.

[3] See: Art. 1 of the Act on the Protection of Animals from 21 August 1997 (J.L. of 2003, № 106, item 1002) and § 90a BGB, which indicate directly that an animal is not a thing, therefore all rules applicable to things that are applied to animals must be applied appropriately, taking into account the differences between animals as living organisms, and other things.

[4] See, e.g.: M. Lubelska-Sazanów, *Odpowiedzialność z tytułu rękojmi za wady fizyczne przy sprzedaży zwierząt*, "Transformacje Prawa Prywatnego" 2015, № 4, pp. 21–41.

service contracts to dogs or horses, for example. Moreover, these provisions covering service contracts are defined differently under German and Polish law. Therefore, although an appropriately in-depth description of these types of contracts is not possible in this paper, due to the short and introductory nature of this publication, it is still worth shining more light on this issue.

This paper sets out to show the fundamental differences in the regulation and definition of service contracts under Polish and German laws, and discuss the broad applicability of these types of contracts to animals. The Polish Civil Code (KC)[5] and the German Civil Code (BGB)[6] have been chosen as an example of comparison, largely because they are regulated on common foundations.[7] The paper also looks mostly at horse sports, where teaching/training contracts are most commonly used. Such contracts are much more popular in Germany than in Poland, and Germany has always been a role model for other European countries with reference to legal issues concerning horses.

[5] Polish Civil Code in the version promulgated on 23 April 1964, last version: J.L. № 16, item 93 as amended.

[6] German Civil Code in the version promulgated on January 2, 2002 (Federal Law Gazette [Bundesgesetzblatt] I page 42, 2909; 2003 I page 738), status of April 1, 2016.

[7] This not only means that both legal systems are based on the modern pandect system, but also that Polish legislators derive a great amount of legal solutions from the experience of their German neighbours. See, for example: the removal of provisions according to the sale of animals as a manner of implementation of Directive 1999/44EC in both countries, whereas Germany scratched out special provisions applicable to animals back in 2002 and Poland copied that legal solution in 2014, although it has been criticised by some representatives of the German doctrine, e.g. J. Adolphsen, *Tierkauf*, [in:] B. Dauner-Lieb, W. Langen, *BGB Schuldrecht. Nomos Kommentar*, pp. 1970–1971; P. Rosbach, *Pferderecht*, p. V – Vorwort. See also general remarks concerning the reform of the law of obligations with reference to animals: J. Adolphsen, *Die Schuldrechtsreformn und der Wegfall des Viehgewährleistungsrechts*, Agrarrecht 2001, № 7, pp. 203–208. Already before the reform of old and obsolete provisions of selling animals, there were differing ideas about the form of the law after the reform, see: M. Sommer, *Der Pferdekauf*, Münster/Westfalen 2000, pp. 109–118. This solution is quite new in the Polish legal system, but has also already been criticised, see: W. Katner in: D. Karczewska, M. Namysłowska, T. Skoczny, *Ustawa o prawach konsumenta*, Warszawa 2015, p. 272.



## General differences in the regulation of service contracts under Polish and German law

Before turning to service contracts concerning animals, it is important first to understand the significant differences in the general qualification and legal structure of service contracts (*umowy o* świadczenie *usług, Dienstverträge*) and mandate contracts (*umowa zlecenia*) in Poland and Germany[8]. They are covered under the respective Civil Codes – in Poland, Article 734 § 1 KC includes a definition of mandate contract, stating that it is "the performance of a specific juridical act for the principal"[9]; in Germany, § 611 BGB sets out that service contracts are where "one person who promises a service is obliged to perform the services promised, and the other party is obliged to grant the agreed remuneration"[10]. Thus, Polish law only deals with mandate contracts[11], i.e. concerning juridical acts, whereas the German treatment of service contracts[12] is understood to cover any services (not only covering juridical acts). This means that the German Civil Code does not differentiate between mandate contracts and other service contracts, and the definition of a service contract covers the performance of factual and juridical actions, whereas the Polish Civil Code

[8] Service contracts are to be understood as a group of contracts involving the performance of any services (Umowy o świadczenie usług, Dienstverträge), whereas a mandate contract is to be understood as a certain type of service contract, defined in the Polish Civil Code as performance of juridical acts for the principal (Umowa zlecenie).

[9] See: Art. 734 KC in the translation of T. Bil, A. Broniek, A. Cincio, M. Kiełbasa: T. Bil, A. Broniek, A. Cincio, M. Kiełbasa (consulted with G. Dannemann, S. Frederick Fischer, F. Zoll), *Kodeks cywilny, Civil Code*, pp. 327–328.

[10] See: K. Schreiber in: R. Schulze (ed.), *Bürgerliches Gesetzbuch. Handkommentar*, Baden-Baden 2012, pp. 870–877; R. Müller-Glöge in: M. Henssler (ed.), *Münchener Kommentar zum BGB*, Vol. IV, München 2012, § 611, side numbers 1–42.

[11] So: T. Bil, A. Broniek, A. Cincio, M. Kiełbasa (consulted with G. Dannemann, S. Frederick Fischer, F. Zoll), *Kodeks cywilny, Civil Code*, p. 333.

[12] See: Translation of the German Civil Code provided by the Langenscheidt Translation Service (regularly updated by Neil Mussett and most recently by Samson Übersetzungen GmbH, Dr. Carmen v. Schöning) for the Federal Ministry of Justice and Consumer Protection (Bundesministerium für Justiz und Verbraucherschutz), according to which the "Diensvertrag" of § 611 BGB is translated as a service contract: http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html (retrieved on June 15, 2016).

includes only a definition of a mandate contract covering the performance of juridical acts[13].

One consequence of this difference is that, under Polish law, all service contracts not specifically defined in the Polish Civil Code or another Polish legal act are treated as "undefined contracts"[14]. However, the differentiation into "defined" and "undefined" contracts is not limited to service contracts, as can be demonstrated by the fact that the most recognisable "undefined" contracts are franchise contracts[15] and factoring contracts[16]. The reason for presenting the differences between "defined" and "undefined" contracts in the Polish legal system is the importance of understanding how to qualify certain service contracts under Polish law, and which rules to apply.

Article 750 KC provides that the provisions applicable to mandate contracts, as defined in Article 734 § 1 KC, are applicable to all "undefined" service contracts *per analogiam*[17]. This makes it important to distinguish between a "defined" contract and an "undefined" one, as the referral from Article 750 KC combines two features of contracts and applies to contracts that are not only "undefined", but also refer to services.[18] These might be contracts providing for the performance of one or more activities by the performing parties. This means that the respective applicability of Article 750 KC applies only to service contracts that are "undefined", i.e. service contracts providing for the performance of actual actions by one of the parties. Contracts providing for the performance of juridical acts are not covered by the scope of Article 750 KC, as they are either regulated by the provisions regulating mandate contracts (Art. 734 KC), or they are regulated by special provisions applicable to other types of contracts concerning juridical acts, e.g. commission contracts (Art. 765 KC) or agency contracts (Art. 758 KC). However, an "undefined" contract may also contain elements that are typical for other "defined" contracts.[19] In this case, the rules applicable to contracts containing elements typical for other "defined" contracts are the rules applicable to a certain "defined" contract – whether defined in the Polish Civil Code or a different Polish legal act, where the *essentialia negotii* are similar to those of an "undefined" contract at hand[20].

[13] See: L. Ogieglo in: J. Rajski (ed.), *System Prawa Prywatnego*, vol. VII, *Prawo zobowiązań – część szczegółowa*, Warszawa 2011, pp. 556–584.

[14] See Art. 750 KC, which states: "The provisions on mandate shall apply accordingly to service contracts not governed by other provisions". See: T. Bil, A. Broniek, A. Cincio, M. Kiełbasa (consulted with G. Dannemann, S. Frederick Fischer, F. Zoll), *Kodeks cywilny, Civil Code*, p. 333.

[15] See: U. Promińska in: W Katner (ed.), *System Prawa Prywatnego*, vol. IX, *Prawo zobowiązań – umowy nienazwane*, Warszawa 2015, pp. 858–883.

[16] See: M. Romanowski, W. Kocot, A. Kappes in: W Katner (ed.), *System Prawa Prywatnego*, vol. IX, *Prawo zobowiązań – umowy nienazwane*, Warszawa 2015, pp. 289–359.

[17] To learn more about the interpretation and scope of application of Art. 750 KC, see: R. Morek in: K. Osajda (ed.), *Kodeks cywilny. Komentarz*, Warszawa 2015, pp. 1507–1509; L. Ogiegło in: K. Pietrzykowski (ed.), *Kodeks cywilny. Komentarz*, pp. 669–671.

[18] P. Machnikowski in: E. Gniewek, P. Machnikowski (ed.), *Kodeks cywilny. Komentarz*, Warszawa 2014, pp. 1411–1413.

[19] P. Machnikowski in: E. Gniewek, P. Machnikowski (ed.), *Kodeks cywilny. Komentarz*, pp. 1411–1413.

[20] See: SN, ruling from 28.10.1999 – II CKN 530/98, OSP 2000, № 7–8, item 118, with an approving gloss of Ewa Rott-Pietrzyk concerning the applicability of Art. 761 § 1 KC to a contract of one-time agency; P. Machnikowski in: E. Gniewek, P. Machnikowski (ed.), *Kodeks cywilny. Komentarz*, pp. 1411–1413.

## Teaching/training contracts and other service contracts most commonly used with reference to animals

The service contracts most commonly used with reference to animals are: commission contracts[21], teaching/training contracts and safe-keeping contracts[22]. The main focus of this paper is on teaching/training contracts, as this service contract is most commonly used with reference to animals, and a more detailed description of all of

[21] The institution of a commission contract is used today for the sale of horses. The lack of business contacts of inexperienced breeders and the buyer's trust in internationally known associations performing auction sales of most successful sport horses make this institution very popular in Germany, and much less popular in Poland. Thus, the German breeds, like Hanoverian, Oldenburg and Holsteiner horses, are known worldwide for their sport track records. Each of the breeds has its own associations in Germany, which performs horse auctions every year. For information about sport track records of horses of a certain breed and their auctions, see the websites of several breed associations. Retrieved February 4, 2016 from: http://www.hannoveraner.com/hannoveraner-verband/; http://oldenburger-pferde.net/;http://holsteiner-verband.de/.

[22] A safe-keeping contract concerns a situation where an animal is left for a period of time in a dog hotel or stable (it also occurs, for example, when leaving an animal in a veterinary clinic, though in this case the agreement at hand would be a combined contract that includes the provision of veterinary services above all).

these contracts is not possible because of the short and introductory character of this publication.

There are several types of service contracts for training animals and/or their owners, and these have to be distinguished. Firstly there are contracts consisting in a trainer teaching a rider on the rider's own horse[23]. Under Polish law, these contracts are considered "undefined" service contracts, for which the provisions concerning mandate contracts under the KC are to be applied accordingly[24]. Under German law, these contracts are qualified as one type of service contract[25]. Under both legal systems they are treated as teaching contracts[26], as the teaching process concerns mainly the rider. He is the one who has to put the trainer's advice into practice while riding the horse – no matter which of them is more experienced (the rider or the horse). The same applies to courses attended by dog owners learning how to interact with their pets with the help of a trainer. Even if the training of a dog involves some actions performed by the trainer himself, in my opinion these contracts still qualify as teaching contracts already recognised by the doctrine. Thus, the trainer's performance still consists mainly in sharing his knowledge in exchange for remuneration[27].

[23] There are no restrictions that would forbid any person from teaching horse riding, though in Germany and in Poland there are several courses offered that are acknowledged by equestrian organisations and can be attended only by trainers with certain skills and experience, having obtained a special title, see: *Die Bundesvereinigung der Berufsreiter, Welchem Reitlehrer kann ich trauen?*, St. Georg 2012, № 11, pp. 64–69; Doszkalanie kadr instruktorsko-trenerskich – Warunki oraz tryb przyznawania i pozbawiania licencji szkoleniowca oraz certyfikatu instruktora szkolenia podstawowego PZJ, retrieved from the website of the Polish Equestrian Association on February 8, 2016: http://pzj.pl/sites/default/files/przepisy/doszkalanie_kadr_regulamin_2015_02_12.pdf.

[24] With reference to teaching contracts and its recognition in Polish and German law, compare: L. Ogiegło in: J. Rajski (ed.), *System Prawa Prywatnego*, vol. VII, *Prawo zobowiązań – część szczegółowa*, pp. 578–579; W. Braun, *Geschäftsverträge*, Stuttgart 2007, pp. 941–943. Compare also the decisions of the Polish Appellate Courts' decisions: SA Łódź, ruling from 19.6.2013, III AUa 1511/12; SA Gdańsk, ruling from 19.3.2015, III AUa 2736/13.

[25] Idem. See also: W. Braun, *Geschäftsverträge*, Stuttgart 2007, pp. 942–943, who differentiates distance and stationary teaching contracts.

[26] With reference to the qualification of the contract as a teaching contract, see: SA Łódź, ruling from 19.6.2013, III AUa 1511/12;SA Gdańsk, ruling from 19.3.2015, III AUa 2736/13.

[27] So: M. Fuchs in: H. Bamberger, H. Roth (ed.), *Beck'scher Online-Kommentar BGB*, München 2015, § 611, side-number 26. With reference to the reliance between the remuneration and qualification of a contract as a service contract under Polish law: Ł. Ogiegło, in: J. Rajski (ed.), *System Prawa Prywatnego*, vol. VII, *Prawo zobowiązań – część szczegółowa*, pp. 559–560.



Secondly, there are also service contracts that consist in training just the animal (the trainer trains an animal as the rider[28] or as a person giving commands from the ground – where it concerns dogs or other animals). If the animal's owner is not nearby, the animal's trainer is under a much broader contractual obligation than where the trainer only gives advice to the animal's owner, or interacts with the animal with its owner's help.

## Training an animal as a specific type of service contract

This section looks more closely at the second type of service contract presented above. The first type of contract primarily concerns teaching an animal's owner, whereas contracts to train an animal have a more complicated structure because of the special regulation of the trainer's duties with reference to an animal. As the trainer is not only obliged to train an animal, but also to take comprehensive care of it. This type of contract is treated as "undefined" under the Polish legal system, while under German law it qualifies as a service contract, as the definition of service contract is much broader under German law than under Polish law. The trainer has to undertake both factual and legal actions, as the contract consists not only in training an animal (factual action) and in taking care of it (performance of other additional services, such as grooming, feeding, lunging, etc., i.e. also factual actions), but also concluding contracts with other persons who interact with the animal during its training (concluding contracts with the owner of the stable where the trainer keeps the horse, with the blacksmith, with the veterinary doctor, etc., i.e. legal actions). As the German Civil Code definition of a service contract allows factual and legal actions undertaken by the party undertaking the service[29], the contract to train an animal (in the meaning as presented under this title) is treated as a service contract under German law. Howev-

[28] Compare: regulations concerning the profession of a horse rider, retrieved on February 10, 2016 from:http://www.pferd-aktuell.de/ausbildung/berufsausbildung/berufsausbildung; http://www.pzj.pl/node/zawód-jeździec/.

[29] See: § 611 BGB.

er, as the Polish Civil Code definition only concerns legal actions by the party undertaking the service[30], the contract to train an animal is treated as an "undefined" contract under Polish law. The provisions applicable to service contracts are applied accordingly[31].

The parties may conclude a contract to train an animal by any means[32]. It is often concluded by the implied conduct of the parties[33], though deciding on a written form of contract is a wise choice. A written contract not only constitutes proof that can be used for possible disputes that may arise in the future, but also clearly confirms the parties' contractual duties, their possibilities to end the contractual relations, as well as liability issues. As the contract to train an animal is qualified as a service contract under both legal systems, the trainer is obliged to ensure the careful performance of a contract, not to achieve a specific result[34]. Thus, it is difficult to oblige a trainer to achieve a special result with reference to an animal's skills, e.g. although it might be possible to teach every dog to retrieve, there would have to exist a further definition of this skill (how quickly the dog has to pick up the object, how close he has to bring it to the owner, how many times he can resist performing the command in order to still classify this skill as learned). The issue is even more complicated with sport horses, where the definition of a good jumping horse or the correct performance of a flying change of leg by a dressage horse is extremely subjective. However, there is nothing to stop the parties from establishing

[30] See: Art. 734 § 1 KC.

[31] See: Art. 750 § 1 KC.K. Osajda (ed.), *Kodeks cywilny. Komentarz*, pp. 1507–1509; P. Machnikowski in: E. Gniewek, P. Machnikowski (ed.), *Kodeks cywilny. Komentarz*, pp. 1411–1413.

[32] See e.g.: K. Schreiber in: R. Schulze (ed.), *Bürgerliches Gesetzbuch. Handkommentar*, Baden-Baden 2012, p. 873; J. Rajski in: J. Rajski (ed.), *System Prawa Prywatnego*, vol. VII, *Prawo zobowiązań – część szczegółowa*, Warszawa 2011, p. 563. See also: M. Fuchs in: H. Bamberger, H. Roth (ed.), *Beck'scher Online-Kommentar BGB*, München 2015, § 611, side-number 49 in reference to form requirements in some professions.

[33] M. Fuchs in: H. Bamberger, H. Roth (ed.), *Beck'scher Online-Kommentar BGB*, München 2015, § 611, side-number 47.

[34] W. Braun, *Geschäftsverträge*, Stuttgart 2007, p. 779; L. Ogieglo in: J. Rajski (ed.), *System Prawa Prywatnego*, vol. VII, *Prawo zobowiązań – część szczegółowa*, Warszawa 2011, p. 572; P. Machnikowski in: E. Gniewek, P. Machnikowski (ed.), *Kodeks cywilny. Komentarz*, pp. 1411–1413; whereas the authors acknowledge the fact that service contracts are classified as contracts obliging the debtor to a careful performance (not a special result), though represent the opinion that this classification is misleading and should not be followed, or at least needs to be completed with some remarks.



an additional price for the trainer in the event of achieving a special result (such as winning a certain competition on a trained horse), e.g. in the form of a provision. Obliging the trainer to perform a certain result as the main contractual duty would affect the legal character of the contract. Thus, under German law such a contract would not be classified as a service contract at all[35], whereas under Polish law it would be disputable[36].

The trainer is obliged to perform the contract personally[37], which constitutes an issue of special importance for the animal's owner. Thus, the trainer's obligation to take care of an animal makes the contract to train an animal a relation strongly based on mutual trust. Moreover, the animal's owner needs to believe in the training methods used by a particular trainer, who has to make numerous decisions concerning the animal's training every day (i.e. the trainer's reaction with reference to a certain behaviour by an animal, decisions that are important for all the process of learning and which depend on the methods used by different trainers). Therefore, the possibility of subcontracting the animal's training, or any activities connected with taking care for him (grooming, lunging, shoeing the horse, etc.), to another person is possible only if explicitly foreseen in the contract[38].

The parties are free to establish their contract, thus they may contain in the contract any provisions that are not against the law[39], the nature of the obligation and the fair-dealing principle[40]. Therefore,

[35] K. Schreiber in: R. Schulze (ed.), *Bürgerliches Gesetzbuch. Handkommentar*, Baden-Baden 2012, p. 871; R. Müller-Glöge in: M. Henssler (ed.), *Münchener Kommentar zum BGB*, Vol. IV, München 2012, § 611, side numbers 22–26.

[36] L. Ogiegło in: J. Rajski (ed.), *System Prawa Prywatnego*, vol. VII, *Prawo zobowiązań – część szczegółowa*, Warszawa 2011, pp. 571–572. Compare also the decision of the Apellate Court in Gdańsk: SA Gdańsk, ruling from 19.3.2015, III AUa 2736/13.

[37] See: Art. 738 KC and § 613 BGB.

[38] K. Schreiber in: R. Schulze (ed.), *Bürgerliches Gesetzbuch. Handkommentar*, Baden-Baden 2012, p. 879; P. Machnikowski in: E. Gniewek, P. Machnikowski (ed.), *Kodeks cywilny. Komentarz*, pp. 1411–1413.

[39] See: M. Fuchs in: H. Bamberger, H. Roth (ed.), *Beck'scher Online-Kommentar BGB*, München 2015, § 611, side-number 55, who indicates that service contracts (together with contracts for work) are the biggest group of contracts considered in reference to § 134 BGB.

[40] In reference to the freedom of contract, see: E. Rott-Pietrzyk, *Commercial Agency Contracts and Freedom of Contract*, [in:] T. Drygala, B. Heiderhoff, M. Staake, G. Zmij (ed.), *Private Autonomy in Germany and in Poland and in Private European Sales Law*, Munich 2012, pp. 15–34; M. Lubelska-Sazanów, *The "Principle of No Freedom of Contract": A*

it is very important to define the contractual obligations of the parties very carefully, especially with reference to contracts not defined in the Civil Code, like the contract to train an animal – even if there is no legal necessity to do it.

## Summary

There are numerous types of service contracts that concern animals. The common application of contracts concluded with specialists such as: veterinary doctors, blacksmiths, trainers, hotel owners or groomers proves that deeper consideration of their regulation is needed. Most of these contracts are qualified as service contracts under German law, and as "undefined" service contracts, for which the provisions according to mandate contracts are applicable accordingly under Polish law[41]. Thus, its uniqueness consists not only of the respective applicability of provisions concerning goods to animals, but also of a respective applicability of provisions concerning service contracts to "undefined" contracts under Polish law. What is more, the regulation of service contracts as a whole presents a very complex and widely discussed problem on the level of European law. The popularity of contracts on training an animal on one hand, and its differing regulation in different European countries, presented here using the example of Poland and Germany on the other hand, proves its practical relevance. Thus, the short introduction to the problem presented in this paper shows that the issue of service contracts concerning animals should not be underestimated by scholars, and that there is a need for a broader consideration of this particular legal problem.

*Post-Modern Version of the Freedom of Contract Principle?*, [in:] M. de Maestri, S. Dominelli (ed.), *Party autonomy in European private (and) international law*, Tome II, Rome 2015, pp. 15–31.

[41] As the German Civil Code definition of a service contract allows factual and legal actions by the party undertaking the service, these contracts are treated as service contracts under German law. However, as the Polish Civil Code definition of a mandate contract allows only legal actions by the party undertaking the service, these contracts are treated as "undefined" under Polish law. The provisions applicable to service contracts apply accordingly.

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# CONTRACT OF MEDICAL INSURANCE IN UKRAINE: LEGAL DESCRIPTION

## Introduction

In modern society the probability of the occurrence of unforeseen situations that threaten the health and life of the persons increases daily. Due to this fact each person tends to protect him or herself from any possible dangers and risks that may occur. Among the means of protection the insurance protection which is offered by the insurance companies is a dominant one. Attending insurance agency, the insurer enters the contract of medical insurance, which appears to be a legal document that mediates the process of providing of insurance services by the insurer to the insured. Medical insurance is a form of social defence of the person against all the risks related to the loss of health. The essence of medical insurance is to provide an insurance settlement to those citizens who received some medical care and other expenses related to the maintenance of health.

Medical insurance is a system of relations of the protection of property and non-property interests of individuals in the health care sector. Ukrainian legislation does not contain a special legal act regulating this certain area of relations, that is why in practice they are regulated by general norms of the contractual law, contained in the Civil Code of Ukraine and other acts of civil legislation. However sometimes the specifity of these relations is ignored by general rules.

In this regard the legal characteristics of the contract of medical insurance is to be presented in this paper.

## Main features of the contract of medical insurance

According to the Article 979 of the Civil Code of Ukraine the insurance contract is a contract under which one party (the insurer) is obligated in the case of the occurrence of a specific event (insured accident) to pay to the other party (the insured) or another person named in the contract, a certain amount of money (insurance settlement), and the insurer is obligated to pay amount insured and perform other actions under the contract[1]. The Law of Ukraine "On Insurance" (Article 16), in addition, focuses on the a mandatory written form of the contract, and also on the possibility of laying upon the insurer the obligation not only to make the insurance payment, but also to provide a certain assistance, perform certain services etc.[2].

## The main features of a contract of medical insurance:

1) The Autonomy of the contract of medical insurance. It can exist along with the other types of civil contracts. For example, a contract of insurance upon lives of a debtor provides the possibility of a full loan satisfaction under the loan contract or regular payments in case of the insured events happen. In this case, the creditor plays double part in the relations turning into a insurer as well as remaining to be a creditor at the same time. It should be noted that those two roles are different by nature as they are drawn from different relations.

2) Aleatory nature of the contract. Insurance relations emerge and exist only if the insurer possesses a certain insurance interest. It could be some possible losses that he may incur as a result of the occurrence of a certain insured event. The insurer does not know whether he will have to fulfill his obligations to pay the amount insured or not; there is also an uncertainty regarding the time of the insured event, the sum of the amount insured etc. At the same time, the insured cannot know whether it will be him or a beneficiary who will eventually get

[1] Civil Code of Ukraine. Retrieved June 15, 2016 from: http://zakon3.rada.gov.ua/laws/show/435-15.

[2] Law of Ukraine "About insurance". Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/85/96-%D0%B2%D1%80.



the amount insured. In other words the obligation has the mutual aleatory nature, as the insured is obligated to pay the insurance fee even if an insurance event does not occur. The insurer, in his turn, is obligated to make an insurance settlement, even if its sum is much higher than the sums received from the insured[3].

3) The contract of medical insurance does not belong to the contracts containing some suspensive condition which provoke some legal consequences (conditional contracts). The insured event is defined as an essential term of the insurance contract and not an additional one. The rights and obligations under the contract of medical insurance arise immediately after setting the contract, but the subject of a specific obligation ie the action required from the obliged person depends on the occurrence of certain circumstances (events). When the insurance event occurs, the insurer does not achieve any new obligations connected with the insurance settlement under the contract as the obligation to make an insurance settlement was laid upon him right after signing the contract. If the insurance event occurs the insurer is only obliged to fulfill the duty, which was originally taken upon him by signing the contract[4].

4) Bilateralness of the contract. It means that the parties have mutual, defined by a contract, rights and obligations. However, the peculiarity of such a contract is that the obligations of one party under the contract comes up much later then the obligations of the other party. Unlike the obligation of the insured, the insurer's obligation to pay the amount insured comes up later or may not come up at all. This peculiarity is defined by the existence of certain insurance risks.

5) A random nature of the insured event that may occur objectively and unexpectedly (death, illness, accident). Its accidental nature equalizes the positions of insurer and insured at the conclusion of a contract of medical insurance because such events may occur or not occur.

6) Paid contract. The paid character of the contract is represented by the insurance payments (insurance premium, insurance bonus) of

[3] T.V. Bodnar, O.V. Dzera, N.S. Kuznietsova and others, *Contractual law of Ukraine. Special part.*, Kyiv 2009, p. 753.

[4] Ibidem, p. 755.

the insured and by the insurance settlement of the insurer, when the insured event occurs[5].

7) The contract of medical insurance is concluded and generates legal consequences as a legal fact, from the moment of committing of certain actions by its parties. According to the Article 983 of the Civil Code of Ukraine and Article 18 of the Law of Ukraine "On Insurance" the insurance contract is considered concluded from the moment of making the first insurance payment, unless other is provided by the contract of insurance[6]. So, as a rule, the first insurance payment is a law setting fact, which provokes the appearance of the civil relationships under the contract.

In practice the contract of medical insurance comes into force at 00:00 the day, following the day of the receipt of the insurance payments on the insurer's account.

8) Public nature of the contract of medical insurance. The conditions of the public contracts are set to be the same for everyone. The insurer designs and approves the rules of insurance and insurance tariffs that are obligatory for him. Publicity of the contract of medical insurance is brightly represented when the insurer comes out with the public offer to conduct the contract by publishing terms of insurance.

Insurance companies usually deny public character of the insurance contracts. They motivate their position by the article 633 of the Civil Code of Ukraine which defines the possibility of a consumer in case of the groundless refusal of the entrepreneur from the conclusion of the public contract to claim damages, inflicted to the consumer by such refusal. According to it, the recognition of such a contract to be a public one will violate such principles of civil law as a freedom of contract and free will of the parties.

The fact that the contracts of insurance belong to those contracts which are offered by one party to another only to accept it's previously settled terms caused stormy discussions among scientists. Supporters of such a position stated that Article 16 of the Law of Ukraine "On insurance", declares that the contracts of insurance are to be concluded in accordance with the rules of insurance. The rules of insurance are produced by an insurer on his own. In practice insured cannot substantially influence on forming the terms of the contract, he can only choose the variant of behavior, offered by an insurer in the Rules of insurance.

[5] Law of Ukraine "About insurance". Retrieved June 15, 2016 from: http://zakon5.rada.gov.ua/laws/show/85/96-%D0%B2%D1%80.

[6] Ibidem.



The opponents of such a position state that the insurer can only set general terms of the insurance contract according to the rules of insurance made for each type of insurance contract. The specific terms should be defined by the parties by mutual content. That is, the specified, terms (amount insured, the object of insurance, etc.) may not fully coincide with the Rules of insurance if the party agree to that.

Therefore, we can assume that the contract of medical insurance is not the contract of adhesion in the common understanding. At while its conclusion the insured can offer some terms to the insurer and the latter can consider whether to accept them or not to accept.

## Parties of contract of medical insurance

According to the legislative definition of the contract of insurance, the parties of contract of medical insurance are an insurer and insured.

**Insurer.** Insurance is a type of entrepreneurial activity, thus law sets some limitations relating the parties that can carry out such an activity.

An insurer is a legal entity that is specially created for the insurance activity and got a license for doing such an activity according to the law. Requirements that insurers should follow as well as a licensing of their activity and the forms of state supervision over the insurance activity are regulated only by a law[7].

Insurers are the financial institutions that have been created in the form of joint-stock, complete or limited liability partnership, and also those which received the license for the insurance activity. The participants of an insurane agencies it must be not less than three[8].

The terms «insurance agency», «insurance company», «insurance organization» and other similar terms are allowed to be used as the

[7] T.V. Bodnar, O.V. Dzera, N.S. Kuznietsova and others, *Contractual law of Ukraine. Special part.*, Kyiv 2009, p. 761.

[8] Law of Ukraine "About insurance". Retrieved June 15, 2015 from: http://zakon5.rada.gov.ua/laws/show/85/96-%D0%B2%D1%80.

name of only those legal entities that have a license for the insurance activity. According to the Law of Ukraine "On insurance" and the Law of Ukraine "On the financial services and State regulation of financial services" the legal entitues acquire the status of the financial institution after putting the corresponding record about the registration of it into the State Register. The legal entity gets the right to exercise such an activity only after obtaining the appropriate licenses that can not be passed to any third parties[9].

The insurers direct activity can only be insurance and reinsurance (insurance by one insurer on the certain contractual terms at the risk of implementation of part of the obligations by other insurer (reinsurer)) and financial activity, related with the formation, the placement of insurance reserves and their management.

The insurers that provide the life insurance, can give loans to the insured who concluded contracts of life-insurance.

Insurers can form unions, associations and other incorporations to coordinate their activities, to protect their interests and to implement some joint programs if their implementation is at law of Ukraine. However, these associations have no right to commit the direct insurance activity. The associations of insurers work on the statutory basis and acquire rights of legal entity after their state registration.

Individuals and legal entities for the purpose of insurance protection of their property interests can create partnerships of mutual insurance, under the legislation of Ukraine.

In Ukraine National joint stock insurance company "Oranta" takes one of the leading positions among all the insurance companies,. It carries out all the types of medical insurance activity on the territory of Ukraine.

**Insured**. According to the Law of Ukraine "On insurance" insureds are capable individuals or legal entities that have concluded the contracts of insurance or are insured under the legislation of Ukraine.

As insurance relationships have the risky nature they remain under a constant influence of the person's legal capacity or incapacity. The right and obligations of the insured – the person that is confirmed legally incapable, are concluded by a guardian from the very

[9] T.V. Bodnar, O.V. Dzera, N.S. Kuznietsova and others, *Contractual law of Ukraine. Special part.*, Kyiv 2009, p. 761.



moment person's incapacity is confirmed. Insured whose civil capacity is limited by the court, can not fully exercise their will under the contract of medical insurance, because it goes beyond the scope of capability of such a person. Such a realization can be executed only by the trustee in such cases.

As a rule, the insured is the person who is the bearer of the relevant risks. At the same time it is not excluded that a contract of medical insurance can contain as the subject the property and non-property interests of another person.

In a case of a death of insured at the conclusion of the contract of medical insurance for the benefit of the third person, the contract does not break as the subject of such a contract are property and non-property interests of the insured person. So this person can directly enter in the contract as the insured, having all the rights and obligations of the predecessor. If the person under different circumstances (age, health, being under guardianship, etc.) can not enter into a contract of medical insurance, the legal status of the insured under this contract can be vested to the parents, adoptive parents, guardians, trustees or other persons who are required to take measures to protect the rights and interests of such a person. Refuse of an adult capable person on the benefit of whom the insurance contract was concluded, from the rights and obligations under such a contract leads to the termination of a contract of health insurance with all the consequences due to the current legislation[10].

The legislation allows the insured to conclude a contract of medical insurance for the benefit of the third person (insured person) or for the person who will, in case of insured event, acquire rights on the receipt of insurance settlement (beneficiary).

Appointment of a beneficiary is not determined to be an essential term of the contract of medical insurance that is why the insurer has the right to change beneficiary on his own by notifying the insurer. Thus a right on the change of a beneficiary can be limited by the contract of medical insurance.

The peculiarity of the legal status of the beneficiary is that he has the right to require the insurer's fulfillment of his obligations, includ-

[10] T.V. Bodnar, O.V. Dzera, N.S. Kuznietsova and others, *Contractual law of Ukraine. Special part.*, Kyiv 2009, p. 757.

ing making an insurance settlement. At the same time, the insurer that concluded a contract of medical insurance for the benefit of beneficiary is not released from his obligations under the contract, even if it is concluded in favor of the beneficiary[11].

When the contract names the insured person and the beneficiary, the subject of this insurance contract is the interests of the insured person, but for the benefit of beneficiary. The replacement of the beneficiary after the occurrence of the insurance event is impossible, as after the event a new legal relationships arise, one of the parties of which is the beneficiary[12].

Nowadays, the compulsory medical insurance in Ukraine exists only on the level of projects and discussions.

During the signing of the contract of medical insurance the insurance rules define the list of insurance events and corresponding medical services that should be provided to the insured persons.

The contract of medical insurance must include:
- the medical insurance programs selected by the insured;
- the list of medical establishments the insured person has a right to apply to;
- individual insurance tariffs;
- the calculation of insurance payments for each insured person.

The insurance companies of Ukraine offer to choose between a standard complex insurance programs or private insurance programs. Overseas the full insurance program of a contract of medical insurance often includes assistance from about 1000 diseases, 1500–2000 individual medical services, united in the different sets[13].

Insurance companies conclude contracts only with those medical hospital and establishments, which have passed state registration and accreditation.

These contracts contain following conditions:
- procedure of granting of medical services to the insured persons;
- provision of expertise;

[11] Ibidem, p. 760.
[12] Ibidem.
[13] N.G. Nahaychuk, *Peculiarities of organization of medical insurance of population*, Retrieved June 15, 2016 from: http://dspace.uabs.edu.ua/jspui/bitstream/123456789/1072/3/%D0%9D%D0%B0%D0%B3%D0%B0%D0%B9%D1%87%D1%83%D0%BA%201.pdf.



- the possible discounts on the tariffs for medical care, etc.[14].

The next level of conclusion of the contract of medical insurance is the determination of the insurance tariffs. They are defined as a percentage (usually they range from 10% to 30% per year from payment of the amount insured), or in absolute sums. The size of the insurance payments for each insured person is determined independently, taking into account the amount insured that are determined by the contract.

An insurance company plays an important part in the relationship between the patient and the medical establishment. It must protect the rights of the insured person, and also carry out the assistance in choosing a doctor, alternative treatment methods and medical institutions as well. Defending the interests of insured persons, an insurer may pay the losses connected with the harm to the health of the insured person caused by medical workers or medical establishments.

## Conclusions

Summing up all mentioned above, it should be said, that the contract of medical insurance is the autonomous, paid, bilateral, real and public contract. It cannot be defined as a contract of adhesion in the common understanding.

The parties of the contract of medical insurance are insurer and insured and also the insurance relationship can have place between the insured person and the beneficiary as well.

[14] Ibidem.

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# INTERPRETATIVE PROVISIONS IN THE UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS – A GENERAL OVERVIEW

The United Nations Convention on Contracts for the International Sales of Goods [hereinafter as: *the CISG*; *the Vienna Convention*], is an international commercial law treaty that came into force in 1988, after being signed in Vienna on 11 April 1980, under the auspices of UNCITRAL[1]. The CISG provisions arose from negotiations between various states, proposing a 'safe middle ground' as to the sale of goods contracts between different legal systems and different legal cultures, such as civil or common law[2]. The CISG is intended to facilitate international transactions – it was drafted to provide a neutral set of rules that are specifically tailored for the needs of B2B international sales contracts, without favouring either national legal system[3]. Once a state adopts and signs (ratifies) the CISG, its provisions automatically become part of the national legal system of that state. As a result, when the prerequisites for applying the Convention are met (B2B international sale of goods contracts), the CISG automatically applies to that international sales transaction between business entities – unless the parties to an international contract expressly '*opt-out*' from its provisions (Article 6). Today, international sales contracts are frequently governed by the CISG, as it has been ratified by the major trading countries[4]. Therefore, as the buyers and sellers from various legal cultures are nowadays bound by the rules and principles of the CISG, the issues concerning its uniform interpretation require special attention. The CISG sets out guidelines for its interpretation and understanding in its Article 7. Moreover, it contains a provision aimed at interpreting the juridical acts of the parties'– the interpretation of the parties' '*statements and conducts*' (Article 8), with regard to the established trade usages. In this respect, this paper will briefly look more closely at the interpretative provisions of the CISG, as set out in its Article 7 and the Article 8 concerning the interpretation of the contract.

[1] UNCITRAL – United Nations Commission on International Trade Law.

[2] T. Keily, *Harmonisation and the United Nations Convention on Contracts for the International Sale of Goods, the Nordic Journal of Commercial Law of the University of Turku*, Finland, Issue 2003, p. 1.3.

[3] I. Schwenzer, *Commentary on the UN Convention on the International Sale of Goods*, New York, 2010, Art. 6; Pohl, CISG and the Freedom of Form Principle vs. Reservations under Article 96 of the CISG, "Transformacje Prawa Prywatnego" 2/2015, p. 31.



## The interpretation of the Convention–Article 7(1) CISG

In accordance with its preamble, the CISG's ultimate aim is to achieve global uniformity in the law of international sale contracts, not least in order to promote friendly relations between states and to reduce legal uncertainties[5]. In this respect, it is vital that the Convention's rules are understood in a common manner and applied uniformly[6]. However, as it has been well observed, it is not sufficient to simply enact uniform rules; what is vital is the *uniform interpretation* of those rules[7]. In this regard, Article 7(1) CISG has been drafted in order to secure and set guidelines for the autonomous interpretation

[4] CISG has been adopted by 84 countries (Within EU, 24 out of the 28 Member States, the exceptions are Ireland, Malta, Portugal and the United Kingdom). See: http://www.cisg.law.pace.edu/cisg/countries/cntries.html. [Retrieved June 15, 2016].

[5] See: the Convention's preamble. At: http://www.cisg.law.pace.edu/cisg/text/preamble.html.

[6] F. Ferrari, *Tribunale di Vigevano: Specific Aspects of the CISG Uniformly Dealt With*, "20 Journal of Law and Commerce" 2001, p. 225; R.J.C. Munday, *Comment, The Uniform Interpretation of International Conventions*, 27 INT'L & COMP. L.Q., 1978, p. 450.

[7] F. Ferrari, *The CISG's interpretative Goals, Its Interpretative Method and Its General Principles in Case Law (Part I)*, "Internationales Handelsrecht" 4/2013, p. 137; C.B. Andersen, *Uniform Application of the International Sales Law: Understanding Uniformity*, "The Global Jurisconsultorium and Examination and Notification Provisions of the CISG" 2007, p. 3.

of its provisions, setting out three basic principles: upholding the Convention's international character, promoting uniformity in its application and observing *good faith* in international trade. By definition, the primary objective of "*uniform law*" calls for its common interpretation, and in this respect the objective is addressed to the adjudicators, thus to the national court judges and arbitral tribunals[8]. First and foremost, when applying the Convention the adjudicators should bear in mind its international character, i.e. the main concepts, structure, and provisions should be carefully analysed in light of its international background[9]. Any recourse to the national, domestic law in its methodology of interpretation and understanding should be avoided– the adjudicator should not read the Convention '*through the lens of domestic law*'[10]. Therefore, the principle of autonomous interpretation should be understood independently of the national law or any other domestic preconceptions[11], even if the particular domestic law possesses legal terms or phrases with similar wording to the Convention – '*the meaning given to a term used in the convention is not necessarily the same as the meaning accorded to it in a specific legal system that uses the same term*'[12]. Therefore, the conclusion should not be drawn too easily, based on similar wording between the Convention and provisions of domestic law. It is worth noting that the English text of the CISG was translated into six language versions corresponding to the official languages of the United Nations[13], each

[8] P. Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Munich, 2005, p. 97; J. Felemegas, The *United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation, Pace Review of the Convention on Contracts for the International Sale of Goods (CISG)*, "Kluwer Law International" 2000–2001, p. 115.

[9] B. Zeller, *Good Faith – The Scarlet Pimpernel of the CISG, Pace essay, 1 July 2000, part iii; F. Ferrari, Applying the CISG in a Truly Uniform Manner: Tribunale di Vigevano (Italy), 12 July 2000*, "Uniform Law Review / Revue de Droit Uniforme" 2001–1, p. 203.

[10] F. Ferrari, *Uniform Interpretation of the 1980 Uniform Sales Law*, "24 Georgia Journal of International and Comparative Law" 1994–95, p. 188; F. Ferrari, *CISG Case Law: A New Challenge for Interpreters?*, "17 Journal of Law and Commerce" 1999, p. 245, J.O. Honnold, *The Sales Convention in Action – Uniform International Words: Uniform Applications?*, "Journal of Law & Commerce" 1988, pp. 207–208.

[11] C.M. Bianca, M.J. Bonell, *Commentary on the International Sales Law*, "The 1980 Vienna Sales Convention" Milan, 1987, Article 7, note 2.2.2.; I. Schwenzer, *Commentary...*, 2010, p. 123; P. Schlechtriem, *Commentary...*, 2005, p. 94.

[12] Id. P. Schlechtriem, p. 97.

[13] These languages are: Arabic, Chinese, English, French, Russian and Spanish.



equally authentic[14]. However, in the event of any ambiguities, discrepancies and disputes that may arise out of the meaning of a particular word, some authors argued that the English version should prevail[15]. The unification process within a society of 84 different states and in the field of the international sales law is naturally a complex process, the principal aims of which can be reached only with considerable time and practice. Achieving the Convention's uniformity largely depends on the manner in which the domestic tribunals interpret its provisions – whether the interpretation of its provisions and the gap-filling of the law will be uniformly and consistently applied[16]. In light of the international character of the Convention and the lack of any international regulatory body[17] or the international equivalent of a supreme court that would be competent to ensure its consistent interpretation and to decide over conflicting interpretations of particular provisions – uniform application and interpretation is a challenging task[18]. Therefore, in order to preserve common meaning in the interpretation of the CISG, the courts and tribunals should take into account foreign academic writings, foreign court decisions and arbitral awards, in order to meet the need to apply the Convention uniformly[19]. To support the unification process, numerous databases have been created to facilitate the mandate of uniform interpre-

[14] In accordance with the final clause of the Convention: "DONE at Vienna, [...] in a single original, of which the Arabic, Chinese, English, French, Russian and Spanish texts are equally authentic".

[15] See: R. Herber in: von Caemmerer/Schlechtriem eds., *Kommentar zum Einheitlichen UN-Kaufrecht*, Beck, 2nd ed. (1995) art. 7, № 22; See also CISG, supra note 2, at art 7. and U. Magnus, *Das UN-Kaufrechttritt in Kraft*, "51 Rabels Zeitschrift für ausländisches und internationales Privatrecht" 123, 128 (1987)', to be found at: http://www.cisg.law.pace.edu/cisg/text/text.html.Also the French version could occasionally help in cases of language discrepancies: Id. P. Schlechtriem, p. 101; I. Schwenzer, *Commentary...*, 2010, p. 130.

[16] 10 March–11 April 1980, Official Records, Documents of the Conference and Summary Records of the Plenary Meetings and of the Meetings of the Main Committee, 1981, p. 18.

[17] W. Gillette, *The UN Convention on Contracts for the International Sale of Goods; Theory and Practice*, Cambridge 2016, p. 3.

[18] R. Illescas Ortiz, P. Perales Viscasillas, *The scope of the Common European Sales Law: B2B, goods, digital content and services*, "Journal of International Trade Law and Policy" 2012, Vol. 11 Iss: 3, p. 243; I. Schwenzer, *Commentary...*, 2010, p. 124; P. Schlechtriem, *Commentary...*, 2005, p. 97.

[19] Id. P. Schlechtriem, p. 102; F. Ferrari, *Applying the CISG in a Truly...*, p. 205; F. Ferrari, *The CISG's interpretative Goals...* (Part I), p. 137.

tation and application of the CISG[20]. Those databases contain international case law, case abstracts, and foreign decisions, all translated into English, as well as articles and a wide range of other literature, with a significant contribution from international academics[21]. Furthermore, a private initiative by international scholars has seen the establishment of the Advisory Council on the CISG, which serves as an independent advisory body, critically analysing international case law and international academic writings over certain controversial or problematic CISG topics[22]. Although foreign court decisions have no binding nature on one another, they may have a persuasive character, and serve the judges with an international and/or common understanding and interpretation of certain provisions[23].

Article 7 CISG, in addition of presenting guidelines concerning its international character and uniform interpretation, further guides the adjudicator to observe *good faith* in international trade[24]. It has been submitted that the express wording of *good faith* articulated therein relates to and calls for *interpretation* of *the Convention* in good faith, rather than setting a duty for the parties to act in accordance with good faith[25]. However, given the principle of the Convention's autonomous interpretation, the problem and question arises as to the relevant standards of *good faith* interpretation, as the CISG is silent about its meaning. Given that there is no autonomous source for giving support and explanation to the *good faith in international trade* principle,[26]it has been suggested that Article 9 CISG may be a helpful 'tool' in determining the interpretative standards of *good faith* in international trade, having regard to all trade usages and practices that the

[20] www.uncitral.org – CLOUT (Case Law on UNCITRAL Texts).

[21] See: www.cisg.law.pace.edu; www.cisg-online.ch; www.uncitral.org; www.uncitral.org/uncitral/en/case_law.html; UNILEX (www.unilex.info); UNCITRAL Digest, AC-CISG. See also: C.M. Germain, *The United Nations Convention on Contracts for the International Sale of Goods: Guide to Research and Literature*, 24 Int'l J. Legal Info. 48, 1996.

[22] About the CISG Advisory Council on the CISG see at: http://www.cisgac.com/index.php; also P. Schlechtriem, *Commentary...*, 2005, p. 98; I. Schwenzer, *Commentary...*, 2010, p. 125.

[23] Id. P. Schlechtriem, pp. 98–99; on average, there are over 3000 reported cases, for instance, in the CISG Database, which is certainly not an exhaustive list of CISG case law.

[24] See Article 7(1) CISG.

[25] Bridge, *The International Sale of Goods*, Oxford 2013, pp. 509–510; Id. P. Schlechtriem, 2005, p. 95.

[26] Id. P. Schlechtriem, p. 100.



parties have established between themselves and other international practices; and usages widely known (*which parties knew or ought to have known*)[27]. Nonetheless, in determining the standard of good faith principle in international trade, the courts and arbitral tribunals should bear in mind the Convention's international character and avoid discourse to the domestic legal systems[28]. On the contrary, opinions can be found where the good faith principle will not be conferred only to the express provisions of the CISG[29], arguing that if the parties derive their contractual rights and obligations in accordance with the Convention–which is to be interpreted in good faith – at the same time it means that the parties' contractual rights and obligations should be interpreted in the same manner, namely in good faith[30]. As an example, many international model laws, such as for instance: UNIDROIT[31] or PECL[32], contain provisions with respect to good faith relating to the parties' acts, for example: '*each party must act in accordance with good faith and fair dealing in international trade*'. As for the CISG, although, in principle, the duty to observe good faith in international trade, asset out in its Article 7(1), primarily refers to the obligation to interpret the Convention in good faith[33], this principle can also serve as a guideline for the parties' themselves, as to posing the requirement to observe good faith when dealing in international B2B transactions[34]. Although there might be a disagreement as to the second sentence, there is generally no controversy that the principle of good faith is one of the Convention's general principles in the understanding of Article 7(2) CISG.

[27] B. Zeller, *CISG and the Unification of International Trade Law*, New York 2007, p. 31; See Article 9 CISG.

[28] P. Schlechtriem, *Commentary...*, 2005, p. 100.

[29] P. Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods*, Oxford 1998, p. 95.

[30] M.G. Bridge, *The International Sale of Goods*, Oxford 2013, p. 510.

[31] UNIDROIT Principles of International Commercial Contracts, UPICC, see: Article 1.7.

[32] Principles of European Contract Law, PECL, see: Article 1: 106.

[33] B. Zeller, *Four-Corners – The Methodology for Interpretation and Application of the UN Convention on Contracts for the International Sale of Goods*, 2003, available at: http://www.cisg.law.pace.edu/cisg/biblio/4corners.html [Retrieved June 15, 2016].

[34] I. Schwenzer, *Commentary...*, 2010, p. 124; P. Schlechtriem, *Good Faith in German Law and in International Uniform Laws, Saggi*, "Conference e Seminari" February 1997, quoted in: B. Zeller, *Good Faith – The Scarlet Pimpernel of the CISG*, Pace essay, 1 July 2000.

## The CISG and gap-filling – Article 7(2) CISG

The Convention sets out rules on contract formation and on the rights and obligations of buyers and sellers, and only applies to the sale of commercial goods[35] – it generally does not apply to the sale of services[36]. Therefore, it is evident that the CISG does not serve as a fully complete and universal commercial code[37], as many issues are not covered by the Convention[38]. Thus, when a dispute arises, the adjudicator must often seek an otherwise applicable law by virtue of the relevant conflict of law rules[39]. In this respect, Article 7(2) deals with the express methodology for dealing with what is known as 'gap-filling' of the Convention (*lacunae iuris*)[40]. The gaps in the Convention can be divided into '*internal gaps*' (matters that are governed by the CISG, but are not expressly stated in it), and '*external gaps*' (which are matters expressly excluded by the CISG– for instance, those in Article 2 and Article 4 CISG) or matters that the Convention is silent about. In accordance with Article 7(2) CISG, the '*internal gaps*' ought to be filled in accordance with the general principles on which the Convention is based. A long list of the Convention's general principles has been created, which are to be implied into the 'gap-filling', such as: party autonomy (Article 6)[41], the question of which party bears the burden of proof[42], freedom of form (Article 11), observing good faith

[35] Article 4 CISG: 'This Convention [...] is not concerned with: (a) the validity of the contract or of any of its provisions or of any usage; (b) the effect which the contract may have on the property in the goods sold'.

[36] See: Article 3 CISG.

[37] F. Ferrari, *What Sources of Law for Contracts for the International Sale of Goods? Why One Has to Look Beyond the CISG*, "International Review of Law and Economics" September 2005, p. 324; I. Schwenzer, *Commentary...*, 2010, p. 143; M. Pazdan, *Konwencja wiedeńska o umowach międzynarodowej sprzedaży. Komentarz*, Kraków 2001, p. 131.

[38] The Convention is divided into four parts. I: sphere of application and general provisions; II: formation of the contract; III: substantive rules for the sales contracts, the parties' rights, obligations and remedies; IV: public international law provisions.

[39] F. Ferrari, *What Sources of Law for Contracts...*, p. 324; I. Schwenzer, *Commentary...*, 2010, p. 143; M. Pazdan, *Konwencja wiedeńska...*, p. 131.

[40] C.M. Bianca, M.J. Bonell, *Commentary...*, pp. 73–74.

[41] F. Ferrari, *The CISG's interpretative Goals, Its Interpretative Method and Its General Principles in Case Law (Part II)*, "Internationales Handelsrecht" 5/2013, p. 190.

[42] Switzerland 28 January 2009 Tribunal cantonal [Higher Cantonal Court] Valais (Fiberglass composite materials case), to be found at: http://cisgw3.law.pace.edu/cases/090128s1.html.



'*in conduct and dealings of the parties with each other*'[43], the principle of *favour contractus* (upholding contracts), the standard of a *reasonable person*[44] or even a uniform project, for example UNIDROIT of PECL principles, may serve as a general standard of gap-filling[45]. The recourse into domestic law by virtue of the relevant conflict of law rules in the gap filling process is restricted to '*external gaps*'. Since the CISG demands uniformity in its interpretation and the application of its rules, it has been suggested that applying domestic law is *ultima ratio*, a 'last resort'[46], thus only when the general principles do not lead to any solution in the gap-filling process[47], or no general principle can be found to resolve the relevant issue.

## The interpretative provisions of Article 8 CISG

While Article 7 deals with interpretation of the law and the gap-filling of the Convention, Article 8 CISG provides the rules that, *expressis verbis*, correspond into the interpretation of the parties' unilateral acts (declarations, statements and the other parties' conduct), made for the purpose of the CISG[48]. In accordance with Article 8(1) CISG: '[f]*or the purposes of this Convention, statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was*'. Therefore, the agreement is not limited to the wording of the written contract, as other indications of the parties' intent (such as individual statements) are considered when determining the content of the contract; (parties' behaviour, conduct, intentions, or reasonable or common understandings). Article 8 is applicable to the pre-contractual communications that lead to the conclusion of the contract of sale – the *negotiation stage* (an offer, an acceptance), as well as to the post-contractual conduct and communications (for example, the

[43] P. Schlechtriem, *Commentary...*, 2005, p. 104.

[44] J.O. Honnold, *Uniform Law for International Sales*, p. 148.

[45] I. Schwenzer, *Commentary...*, 2010, p. 143.

[46] Id. P. Schlechtriem, *Commentary...*, 2005, p. 109.

[47] F. Ferrari, *The CISG's interpretative Goals... (Part II)*, "Internationales Handelsrecht" 5/2013, p. 196.

[48] J.O. Honnold, *Uniform Law for International Sales*, p.162; B. Zeller, *Four-Corners...*

avoidance of the contract)[49].When applying the interpretative rules of Article 8 CISG, reference should be made to the time when the contract was formed, as it is important to determine the parties' understanding of the language at the time of forming the contract, rather than the meaning when the dispute arose. Into this situation, the parties' former understanding will prevail[50]. Article 8 CISG is a broad provision, divided into three subparagraphs. The first step along the interpretation process provided in Article 8(1) is a subjective test[51] that depends on the parties' actual intentions. The parties' *'statements'* and *"other conduct"* are to be interpreted according to *'the intent where the other party knew or could not have been unaware what that intent was'*. The above provision sets out two situations: the parties' actual knowledge, and second, when the party should have had the particular knowledge (*'knew or could not have been unaware'*). It has to be stressed that the subjective test presumes that the parties have a common understanding of the particular meaning of the words and language in general, used for the purpose of their business dealings[52]. The application of Article 8(1) will be relevant only if the parties to the sales contract either have a close relationship, knowing each other well, or where the statements or conduct are clear enough to be simply understood by the other party[53]. In practice, however, the term *'could not have been unaware'* could be ambiguous, as it may be difficult to establish whether one party *knew or could not have been unaware* of the other party's intention, as the courts, when determining the intention, would have to establish the meaning of the statements and conduct. The objective test set out in Article 8(2) (*reasonable person of the same kind*)[54] is applicable if the subjective test ruled by Article 8(1) fails to determine the parties' intent. As it was stated by the Federal Appellate Court, US: *'most cases will not present a situation in which both parties to the contract acknowledge a subjective intent [...].*

[49] C.M. Bianca, M.J. Bonell, *Commentary...*, pp. 97–98.

[50] Id. C.M. Bianca, M.J. Bonell, p. 98; J.M. Perillo in: J. Felemegas, *An International Approach...*, pp. 48–51.

[51] Similarly in Article 4.2 UNIDROIT and Article 5:101 PECL.

[52] P. Schlechtriem, *Commentary...*, 2005, pp. 117–119.

[53] ICC Arbitration Case № 8324 of 1995 (Magnesium case).

[54] E. Rott-Pietrzyk, *Wzorzec rozsądnej osoby w świetle konwencji wiedeńskiej o umowach międzynarodowej sprzedaży towarów*, "Rejent" 2005, Nr 9, pp. 202–222.



*In most cases, therefore, article 8(2) of the* [Convention] *will apply, and objective evidence will provide the basis for the court's decision'*[55]. Therefore, if the subjective test set out in paragraph 1 will be difficult to apply in practice, the objective test provided in the following subparagraph of Article 8 will be relevant[56]. Article 8(2) relies on a standard of the hypothetical understanding of a reasonable person of the same kind as the other party in the same circumstances. The test provided by Article 8(2) requires the courts and tribunals to take a hypothetical approach and to bear in mind the understanding of a reasonable person of the same kind as the other party. To determine a reasonable person, the courts should consider, for instance, all relevant, common circumstances, such as: business matters, technical skills, linguistic backgrounds, or knowledge of prior dealings, negotiations and specific market knowledge (understanding of a *'reasonable business person in the same type of business'*)[57]. *Reasonableness* as a general clause is repeatedly applied to the Convention's rules, and the frequency of its submission[58] in the CISG text indicates its importance[59]. In determining the scope and the meaning of the *reasonableness* clause (and who is to be regarded as a *reasonable person*), it was observed that, by virtue of Article 7(2)[60], the definition set out in Article 1:302 PECL may be supportive[61]. Moreover, Professor Honnold has submitted that, by following the path of the *'promotion of good faith'* set out in Article 7(1), and with reliance to the gap-filling process set out in Article 7(2), the answer to what is a *reasonable* understanding may also be found in Article 9 CISG. By determining the trade usages and practices (to

[55] United States 29 June 1998 Federal Appellate Court [11th Circuit] (MCC-Marble Ceramic Center v. Ceramica Nuova D'Agostino) case number: 97-4250, found at UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods, Article 8.

[56] A. Farnsworth in: *International Sales: The United Nations Convention on Contracts for the International Sale of Goods*, N.M. Galston & H. Smit, M. Bender, Columbia University, New York 1994, pp. 97–98.

[57] P. Schlechtriem, *Commentary...*, 2005, pp. 119–121; UNCITRAL Digest, Article 8.

[58] E. Rott-Pietrzyk, *Klauzula generalna rozsądku...*, p. 255.

[59] Id. p. 253.

[60] The gap-filling in Article 7(2) CISG: applying the general principles on which the Convention is based.

[61] Id. E. Rott-Pietrzyk, p. 255; Kritzer, *Reasonableness, Overview comments on reasonableness, a general principle of CISG*, See: http://www.cisg.law.pace.edu/cisg/text/reason.html#overv.

what is '*normal and acceptable in the relevant trade*')[62], appropriately, what would be *reasonable* ('*normal and acceptable*') by a person from a relevant, common trade background. The court or arbitral tribunal, when applying the objective test, should pay attention to Article 8(3): all relevant circumstances, negotiations, usages, and subsequent conduct, or practices that the parties have established between themselves[63]. A *reasonable person* standard will vary from one case to another, therefore, the courts and tribunals will have to take into account the specific circumstances of the particular case, which are inevitably connected with Article 8(2)[64]. Last but not least, the intent of the party, under the subjective test (Article 8(1)), or the objective, hypothetical understanding of a *reasonable* person (Article 8(2)), should be determined in light of Article 8(3). The last sub-article of Article 8 lists non-exhaustive circumstances that are to be taken into consideration by judges: '*all relevant circumstances of the case,* including *the negotiations, any practices the parties have established between themselves, usages and any subsequent conduct of the parties*'[65]. According to above, in the course of interpreting a contract, the courts will consider the provisions of Article 8, as to the parties' intent, in a reasonable person's understanding, taking into consideration previous negotiations and communication between the parties. The rule for giving significance to all previous communications set out in Article 8(3) is supported by the provision of Article 11 CISG. Article 11 of the Convention establishes the principle of freedom of form requirements, as '*a contract of sale need not be concluded in or evidenced by writing, and is not subject to any other requirement as to form*' [and what is important for the purpose of interpreting previous negotiations] *it may be proved by any means, including witnesses*[66].

[62] J.O. Honnold, *Uniform Law for International Sales*, p. 148; Koneru, *The International Interpretation*; B. Zeller, *Interpretation of Article 8: Is it Consistent with the Function of the Global Jurisconcultorium?*, "Internationales Handelsrecht" 3/2013, p. 90.

[63] Article 8(3) CISG.

[64] E. Rott-Pietrzyk, *Klauzula Generalna Rozsądku...*, p. 271; M. Huber, *The CISG: a New...*, pp. 12–14.

[65] Article 8(3) CISG; B. Zeller, *Determining the Contractual Intent of Parties under the CISG and Common Law – A Comparative Analysis*, "European Journal of Law Reform", Kluwer Law International, Vol. 4, № 4 2002.

[66] See: Article 11 CISG.



## Conclusion

The national provisions regulating sales contracts constitute an important legal instrument of trade law. The creation and successful ratification of the Vienna Convention was a 'uniform answer' to the diversity of the various national legal systems. With respect to the Convention's aims of uniformity within all its contracting states, and considering their different legal backgrounds –the issue regarding its autonomous interpretation is a crucial matter. Articles 7 and 8 CISG are both vital as they regard the issues of interpretation. Article 7 sets out guidelines for the adjudicators on how to interpret the provisions of the Convention and the procedure of filling the gaps. On the other hand, Article 8 provides rules concerning the interpretation of the parties' statements and conduct, which are vital to derive the content of the contract. In practice it might be difficult to reach total uniformity in the manner of interpreting the Convention as such, however, as stated by Professor Honnold, '*we cannot expect perfect uniformity in applying the convention – or, for that matter, any other statute. But we can look forward to international commercial law that is more helpful and predictable than the present Babel of competing systems*"[67].

[67] J.O. Honnold, *The sales convention in action – uniform international words: uniform application*, "8 Journal of Law and Commerce" 1988, p. 240.

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# CONTRACTUAL REGULATION OF ENVIRONMENTAL INSURANCE AS A PART OF ECONOMIC AND LEGAL MECHANISM OF ENVIRONMENTAL PROTECTION

*Formulation of the problem.* Prevention from negative impact in environment is the basic and essential task of environmental and natural resources law. Business activity repeatedly causes environmental pollution, for instance due to gases and dust excessively put into the air or putting sewage or wastes into the ground or water. Very often it leads to serious damages in the environment and people's health and well-being.

Recently, the development of legal resolution of relations of environmental insurance used to be vital part of economic and legal mechanism of environmental protection and environmental security. Environmental insurance is an effective method of prevention and reduction of environmental damage.

Nowadays the general insurance relations in Ukraine are well developed and regulated by laws. But the environmental insurance system is on the early stage of development in spite it was predicted by the Law of Ukraine "On Environmental Protection" adopted in 1991. Any market economy even very young as Ukrainian acting in nature resources use, should ensure the human rights to the safe and health environment through the various risk insurance cover all environmentally hazardous activity of economic entities (exploitation of industrial plants, fossil fuels industry – oil, gas, coal production, transportation, hazardous waste management etc.).



For compensation of damages caused by such activities the system of economic and legal regulation of environmental insurance relations establishes the economic guarantee and financial capacity of environmental protection.

## Analysis of recent research and publications

In Ukraine this topic of environmental insurance was increasingly described in a last 3–4 years by scholars L.M. Hranovska, V.V. Kostytsky, K.M. Zhydenko, R.V. Pikus, S.M. Rohach and others.

*Aim and objectives.* This article is aimed to analyzing and discussing the legal regulation, implementation of environmental insurance in Ukraine and its prospectives and international environmental insurance practices respectively in order to identify gaps and shortcomings in national laws.

The content of research. The current regulatory framework of environmental insurance in Ukraine consists of the Laws of Ukraine "On insurance"; "On Environmental Protection"; "On environmental audit"; "On the transportation of dangerous goods"; "About an increased risk"; "On Oil and Gas"; Cabinet Ministers of Ukraine Resolution "On approval of rules of mandatory insurance of dangerous goods during its transportation"; "On approval of rules of mandatory insurance of the liability of exporter and the person responsible for the disposal (removal) of hazardous waste for compensation for damage to human health, property and the environment during the transboundary transportation and disposal (removal) of hazardous wastes", "On approval of rules of mandatory insurance of liability of entrepreneurs for damage that may be caused by fires and accidents, which can lead to environmental and sanitary-epidemiological disaster".

So, as a result we may divide all existing types of environmental insurance relations fixed in national legislation:

1) environmental insurance of liability of entrepreneurs for damage caused by fires and high risk accidents (environmental and sanitary-epidemiological accidents);
2) environmental insurance of liability of the exporter and the person responsible for the disposal (removal) of hazardous waste for compensation for damage to human health, property and the en-

vironment during the transboundary transportation and disposal (removal) of hazardous wastes;
3) environmental insurance of transportation of dangerous goods in case of damage to the environment;
4) environmental insurance of civil liability of the operator of a nuclear energy plant for nuclear damage due to a potential nuclear incident;
5) environmental insurance of civil liability for environmental damage during the mining of oil and gas deposits;
6) environmental liability insurance of business entities for damage which may be caused to the environment or human health after inappropriate storage and use of pesticides and agrochemicals.

Further implementation of the system of environmental insurance in Ukraine might cause the necessity of analysis of international environmental insurance in order to meet all the challenges. For example, the U.S. environmental insurance system was developed in early 1980s in order to ensure the financial liability of users of hazardous waste facilities and environmental service companies accordingly to the proper local, state, and federal regulations. During two last decades the professional insurers have provided the capacity to ensure all types of liability to exposure confronting businesses and public entities across the United States[1]. But in other countries the progress is still more a further prospective that a current reality.

The international legislation contains the definition "liability for environmental damage – it's financial coverage, environmental insurance". In particular, this definition has been fixed in Convention on Civil Liability for Damage resulting from Activities Dangerous to the Environment (1993). Due to this Convention, each party guarantees the reimbursement.

The same provision is included in a draft of Council Directive on civil liability for damage caused by waste. The liability of the manufacturer or other entrepreneur responsible for neutralization (reduction) of waste ought to be insured by the contract of environmental insurance. Each producer is obliged to include the name of the insurance company that provides the insurance for civil liability, in annual report.

[1] The U.S. Environmental Liability Insurance Market-Reaching New Frontiers.



There are listed types of this damage: a malfunction of holding of oil and others tanks, pesticides, composting green waste and others. Moreover, recent UK and EU legislation has fixed substantially raised the costs of reimbursement of damage. Environmental issues have rapid ability to protect the reputation of business[2].

The 2004 European Commission Environmental Liability Directive (ELD) is as a main act in this field, establishes a framework for environmental liability based on the "polluter pays" principle, aimed to prevent and remedy the caused environmental damage.

Environmental insurance of the specific types of activities that threat to the environment are predicted in German legislative acts on liability for damage caused by environmental offenses. The insurance of potential liability for environmental damage as well is stipulated in Belgium, the Netherlands, Italy, USA, Switzerland, Japan and other countries[3] in such different:

1) Environmental insurance of liability[4]:
- insurance of immovable objects;
- insurance of the pollutant emissions of the ground (underground) tanks;
- insurance of service companies: liability insurance for contractors dealing clearance of territories of buildings material containing lead (Asbestos Abatement liability Insurance);
- insurance from land contamination;
- transportation insurance – insurance of liability of owners of vehicles that pollute the environment;
- insurance of liability of owners of goods delivery companies for environmental pollution during their transportation;

2) environmental property insurance:
- Environmental Insurance of contaminated real estate: insurance of unexpected expanses for cleaning and remediation of contaminated real estate;

[2] Official website of British Association of British insures. Retrieved June 15, 2016 from: https://www.abi.org.uk/Insurance-and-savings/Products/Business-insurance/Liability-insurance/Environmental-liability-insurance.

[3] V. Kostytsky, *Environmental Law. Special Part*, Drogobych 2013, p. 358.

[4] I. Shinkarenko, *Liability Insurance: A Guide*, Kiev 1999, p. 298–303.

- Insurance program that covers all operations of cleaning of contaminated real estate by general limit throughout the whole period of of insurance.

The central definition of every insurance agreement is the environmental risk as Prof. Alberto Monti[5] found, is:

1. the environmental liability risk (i.e. the financial risk associated with environmental pollution and contamination) and
2. the natural catastrophe risk (i.e. the risk of major damages in connection with the occurrence of natural disasters, such as earthquakes, floods or other extreme environmental conditions).

Both these environment-related risks, as mentioned, are characterized by the potential for catastrophic consequences.

From theoretical point of view, Polish environmental law does not include any definition of the ecological insurance issue and does not regulate it in any separate legal act. It is only signalized in the act that is basic for the branch of environmental law which is more and more self- contained among other branches in Polish legal order. It is the article 187 of the Act of 27 April 2007 on Environmental Law [1] where insurance is one of the forms of security of claims due to occurrence of negative results and damage in the environment. Nevertheless, general aspects of the contract of civil liability insurance is regulated in article 822 of Civil Code[6].

The provision of article 187 of the Act on Environmental Law stipulates that in case of occurrence of particularly important social interest related to environmental protection, in particular to danger of environmental condition deterioration in a large scale, as well as to danger of environ- mental damage, in the permission that is mentioned in article 181 of the Act on Environmental Law, there can be established the security of claims due to occurrence of negative results and damage in the environment. In sub- sequent parts of this paper there are indicated forms of security of claims, such as insurance policy, deposit, bank guarantee and insurance guarantee.

[5] A. Monti, *Environmental risks and insurance: a comparative analysis of the role of insurance in the management of environment-related risks*, Retrieved June 15, 2016 from: http://www.oecd.org/finance/financial-markets/1939368.pdf.

[6] Act of April 23, 1963.



Calling the above-mentioned article 181 at this moment demands some short and brief explanation the issue of the permission, understood as the protective instrument that limits emissions to the environment and determines the conditions of conducting business activity that has an impact on the environment. In Polish environmental law there exist two kinds of permissions. First is a sectorial permission (in the scope of putting gases and dust into the air, putting sewage into the ground or water and waste production)[7]. Second is an integrated permission (that is one complex permission for conducting an installation, concerning the whole of the environment). Permissions are being issued as administrative decisions by the authorities of environmental protection, as a rule after submitting an application by the entity conducting the installation[8].

The purpose of insurance is to compensate the damage caused to health or property of a third party (persons whose property interests are affected by technogenic and ecological incident. This policy allows policyholder to keep an interest in increasing the capacity of technologic and ecological security of production.

Prior to compensation the damage due to the pollution levels the special funds may be established through the gathering of contributions from owners of environmentally hazardous activities and objects (e.g. Superfund in the United States). It accumulates fees of enterprises and uses it to financial support of the environmental emergencies and planned disposal of hazardous waste storage[9].

An important step in environmental insurance processes is an agreement of environmental insurance. Concluding such an agreement for any type of environmental insurance, the insurer (in this case a company) meets term "insured event". According to Art. 8 of the Law of Ukraine "On insurance", "insured event" is the event provided by the insurance agreement or in legislation, which took place and insurer's

[7] Articles 180–181 of the Act on Environmental Law.

[8] Z. Bukowski in: J. Ciechanowicz-McLean, Z. Bukowski, B. Rakoczy, *Prawo ochrony środowiska. Komentarz*, Warsaw 2008, p. 352; This is also claimed: M. Górski in: M. Górski, M. Pchałek, W. Radecki, J. Jerzmański, M. Bar, S. Urban, J. Jendroska, *Prawo ochrony środowiska. Komentarz*, Warsaw 2011, p. 751.

[9] I. Abalkina, *Environmental risks insurance (from the US practice)*, Moscow 1998, p. 8–13.

obligation to pay the insured sum (insurance indemnity) to the insured person or other third party, or reimburse the expanses".

So the environmental insurance event is provided by the insurance agreement undesirable event (accident, fire) of high risk that had caused damage to the environment, property, life and health of the persons and entails the obligation of the insurer (insurance company) to reimburse the damage.

Insurance agreement is the written agreement between the insurant and insured person according which the insurant undertakes the duty to make indemnity payments to policyholders or other person specified in the insurance agreement by the insurer due to the insurance event (to provide assistance, service, etc.), and the insurer ought to pay insurance payments in a proper time and reach other conditions of the contract.

Insurance contracts concluded in accordance with legal insurance regulations have to include: name, surname or title the insurer and the insured person, their address and date of birth; name, surname, date of birth or the name and address of the beneficiary; definition of the subject; the insurance amount; the amount of insurance payments under life insurance contracts; a list of insurance events; the size of insurance premium fees and the terms of payment; insurance rate (insurance rate is not defined for insurance; cases which do not set the insured amount); term of the contract; procedure for modification and termination of the contract; the conditions of the insurance payments; reasons for denial of insurance benefits; rights, obligations and the responsibility for f improper performance of the contract obligations; other conditions agreed by the parties and proved by their signatures.

The Law of Ukraine "On insurance" describes the mandatory content of insurance agreement including name, surname, date of birth or title the insured person and the beneficiary or third parties. In environmental insurance regulation term "third parties" usually defines the natural and legal persons, which may be caused by direct damage a result of fire or accidents of high risk, in addition to people who were in labor relations with the insured and those who illegally performs official duties were at high risk enterprise.

Conclusion of the agreement of environmental insurance is a procedure that precedes the environmental audit. This is documented process of gathering reliable information on the environmental activities of the entity and assesses the impact of its activities on the environment.



Insurance agreement is proposed to conclude on the basis of adopted legislative Model Insurance Agreement, which does not leave much leeway to change its conditions to insurer and insured persons both.

In a voluntary insurance agreements the parties already have the ability to determine some certain conditions independently and freely. The conclusion of such an agreement won't become as formalized process and consequently require the attention of the company manager. It's recommended to conclude this agreement with unbiased advice support of specialist.

## Conclusions and further research

According to the Ukrainian legislative rules only specialized agencies that have state permission (license) for this activity may propose insurance services. The implementation of compulsory environmental insurance in Ukraine would not be combined with the mass development of new insurance companies and increasing the insurance market, which has its own specific features. This process should also propose the economic incentives for new insurance (environmental) service companies, including tax benefits and other.

It is also possible to resolve the issue through the establishment of procedures for development the associated environmental insurance pools that will lead the environmental insurance market. Of course, these subsidized costs should be used as a sources of disposal the increased environmental risks. Consequently the financial pressure on those who won't have the mandatory environmental insurance will increase, which eventually can make the unprofitable production. People should be responsible for high risks industries.

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# THE PACULIARITIES OF THE LEGAL REGULATION OF PRELIMINARY CONTRACTS IN UKRAINE

Present conditions under which the contractual regulation is being developed over the years as well as the number of complications of civil relations due to its growth caused the necessity to adopt new civil mechanisms which would add legal certainty to specific relationships between the subjects of civil circulation. The legal implementation of norms on the preliminary contract into the national legislation is aimed at achieving the goals mentioned above.

At the same time, the practice of application of the preliminary contracts allowed to reveal a number of theoretical issues related to specific character of the obligation to conclude a main contract which arises under the preliminary contract. It should be noted that the institution of preliminary contracts had not yet received an adequate doctrinal analysis by local scientists, which in turn led to the fact that relations arising under the conclusion of the preliminary contracts, are not fully covered by current legislation of Ukraine.

The history of preliminary contracts goes back to Roman law, where this legal happening was designed quite detailed. It should be noted that Roman contract law was not only used for regulation of economic relations in Rome, but also was widely used in future to regulate the economic relations that arose and developed due to socio-economic changes in society[1].

[1] V.O. Goncharenko, *The system of contracts of Roman and some issues of its implementation into modern civil legislation of Ukraine*, "University research note" 2005, №3(15), p. 121–125.



Thus, Roman law stated that "the conclusion of the contract may be preceeded by other contract, which establishes the obligation to conclude the main one. Such an agreement may be called preliminary. This contract – pactum de contrahendo – creates a right to demand the conclusion of the main contract, in case when one of the parties avoids its conclusion"[2]. In this case the statement of Roman lawyer, according to which "the essence of the obligation is not to turn anything into somebody possession but to create the link between persons in the sense that something should be given, made or provided to somebody" seems quite reasonable[3].

Famous soviet scientist O. Ioffe noted that due to the degree of completion all civil contracts are divided into preliminary and final, claiming that while preliminary contracts are not directly provided by law, their conclusion is not prohibited and they create a unique obligation – when a certain time expiries to conclude a main agreement. Interesting that O. Ioffe supported the idea of the possibility of compulsory signing the main contract, pointing out that "although the current legislation does not provide such an agreement, it cannot be found illegal, and, moreover, while concluded in the present circumstances, it would have legal force and could have been executed compulsorily"[4].

In general, we can agree that it is works of the scientists of the pre-revolutionary period that became the basis for adopting the rules on preliminary contracts into the Civil Code of the Soviet republics, including the Civil Code of the USSR in 1922. Analyzing the history of establishing the institute of the preliminary contracts it should be noted that legislative confirmation of rules on preliminary contracts in the Civil Code of Ukraine is historically justified.

Legal nature and peculiarities of the preliminary contract are regulated both by the Civil Code of Ukraine and the Commercial Code of Ukraine. However, the concept of the preliminary contract is only provided in the Civil Code of Ukraine. Thus, the current Civil Code

[2] B. Vinsheid, *On the obligations in Roman law*, 1875, p. 464.

[3] *Monuments of Roman Law: Law XII; Institutions of Guy; Digests of Justinian*, Moscow, 1997, p. 608.

[4] Ioffe O.S. Obligational Law. – M.: Law lit., 1975. – 880 p.

of Ukraine (art. 635) regulates the issues related to the form and content of preliminary contracts, the consequences of failure to comply the obligations by the parties of the contract, etc.[5]. In fact, the concept of the preliminary contracts was first fixed legislatively only in 2003, with the adoption of the Civil and Commercial Codes of Ukraine[6]. The Civil Code of Ukraine in Art. 635 indicates that agreements can be called preliminary when its parties are obligated within a specified period (at a certain time) to conclude the contract (main contract) on the terms set by the preliminary contract.

Thus, the essence of the preliminary contract is that its parties are obliged in the future to conclude the main agreement (on the transfer of property, on works, on services, etc.). The preliminary contract or "contract on the contract", as it is sometimes called, in practice determines the conditions under which the parties undertake certain period to conclude the main contract. This contract is primarily required to settle the relations for the emergence of which a number of actions must be taken and which are essential to be made in order to be formalized on a contractual basis. It should be noted that the Civil Code of Ukraine does not contain any restrictions on the agreement, which the parties are entitled to conclude as the preliminary. Therefore, we believe that the parties have the right to agree on the conclusion of any contract in the future.

Thus, the preliminary contract has the following *features*:

1. Will. The contract does not manifest one person (party) will, but the will of two or more, and the will of the parties must match and meet. The local scientists express the position under which "the obligations of the parties under the preliminary contract do not have counter nature, but rather arise from the parallel expression of will of the parties, aimed at achieving equal for each party goal, which in turn makes it difficult to determine the status of creditor and debtor in the obligation under the preliminary contract"[7].

Indeed, if we consider the preliminary contract as an integral contractual relationship we can state the fact that there is not just a coinci-

[5] Civil Code of Ukraine: Law of Ukraine from 16.01.2003. № 435-IV – Art. 356.

[6] Commercial Code of Ukraine: Law of Ukraine from 16.01.2003. № 436-IV – № 19–20, № 21–22. – Art. 182.

[7] Y. Skakun, *Preliminary contracts under the civil legislation of Ukraine*, Kharkiv 2013, p. 174.



dence of will of the contracting parties aimed on the formation of the contractual relationship, there is a concurrency of this will at a certain extent, but still it seems not quite correct to say that the will of the parties in this case aimed at achieving identical goal for each of the parties. We believe that the purpose of contract is unified in all the cases as well as a relationship, generated by the agreement.

2. Aim. Scientific literature suggests that the relationship arising under the preliminary contract, by its nature and character should be defined as organizational non-property obligations, even although in some cases it is aimed at creating property obligations in the future. This position appears to be quite reasonable, since the preliminary contract creates an obligation to conclude the main contract in the future. This obligation has essentially a non-property and rather organizational character as preliminary contract mediates organization and optimization of the further formation of contractual relationship, which is the reason (purpose) of the transaction in this case. It is typical that the legal status of the contracting parties is mixed, because in some ways there is no symmetrical structure of the debtor and the creditor, available for other types of obligations. This implies that the purpose of the contract in this case is legally significant and can be qualified as essential conditions for any and all preliminary contracts. Thus, this contract aims at making its parties to conduct other contract in the future (main).

3. Essential terms. Key characteristic of the preliminary contract is that the main contract must be concluded on the terms specified in the preliminary contract. A set of essential terms covered by the preliminary contract must be fully represented when signing the main contract.

Thus, according to the Civil Code of Ukraine, the essential terms of the main contract, which were not set by the preliminary contract, are to be agreed upon due to the procedure established by the parties of the preliminary contract, if the specific order is not established by civil law. At the same time, the provisions of the Commercial Code of Ukraine are more "strict" in this sense and fix the rule that preliminary contract must contain conditions on the subject and other essential terms of the main contract. As we can see, none of these regulatory acts answers the question about the set of essential terms a preliminary contract should have in order to be qualified as valid and promote sustainable development of contractual obligations.

In general, it should be noted that preliminary contracts contain firstly, the essential terms of the preliminary contract and, secondly, the essential terms of the future main contract. When signing the main contract the parties do not agree on its content because it has already been determined by the preliminary contract and can be changed only by mutual consent or (if the failure to achieve such a consent) at the request of one of them in the court order (in case of a significant change in circumstances that guided the parties to the conclusion of the preliminary contract, under the provisions of Art. 625 of the Civil Code of Ukraine). So, the preliminary contracts may (and quite reasonably) indicate not all but only some of the essential terms of the main contract. This position is dictated by the fact that in case of the possibility to define all the essential terms of the main contract while concluding the preliminary one the need for signing the preliminary contract would no longer exist[8].

Thus, the core of the preliminary contracts contains such essential terms as the subject of the preliminary contract, the term and the subject of the main contract. Of course, the preliminary contracts should contain a term of signing the main contract, otherwise the preliminary contracts become less meaningful, and, moreover, this period should not be too long. In this case there is also a contradiction between provisions of the Civil Code of Ukraine and provisions of the Commercial Code of Ukraine. Civil Code of Ukraine does not provide the deadline for conclusion of the main contract, while the Commercial Code of Ukraine stipulates that the main contract should be concluded not later than one year after signing the preliminary contract. In practice, this question depends entirely on the nature of the subject composition of the contract and nature of relationships, whether they are civil or economic.

One of the main tasks of the preliminary contracts is to provide (stabilize) the relationships between the parties before the conclusion of the main contract, guarantee real opportunity after a certain time to acquire the rights under the same conditions that existed at the time of conclusion of the preliminary contract, even if one of the parties lost interest in such relations.

[8] O.V. Starcev, *Commercial law: text book*, Kiev 2006, p. 208.



4. Freedom of contract. The relative deformation of the contract freedom is one of the characteristic features of the preliminary contracts. Thus, the parties being free at the conclusion of the preliminary contract, at the conclusion of the main contract – usually experience significant, mutual and equivalent restriction of their freedom as the change of the conditions of the preliminary contracts before signing the main one is possible only with the consent of all parties. However, it is not excluded that one of the parties may refuse to sign the main contract, being aware of the limits of liability for such a failure.

That is why the principle of contract freedom at the conclusion of the preliminary contracts gives reason to believe that preliminary contracts, along with other contracts, is the embodiment of freedom on the grounds that the participants have the right to resort to its conclusion by mutual will while establishing certain relationships, becoming at the same time the base (internal factor) for freedom restriction at the conclusion of the main contract in future.

Thus, the preliminary contract is a specific legal phenomenon that mediates relatively separate range of relationships on signing the main contracts in the future. Application of the preliminary contracts allows establishing legal link between the parties of the future (main) contract, when the immediate conclusion is not possible or the parties do not want to create legal relations as strong as under the main contract[9]. Thus, the main reasons for the conclusion of the preliminary contracts are the following: firstly, the desire of both or one of the parties to fix intermediate results achieved during the negotiations, secondly, the need to confirm the seriousness of intentions of the parties to the main contract; thirdly, the desire of one or both parties to limit other party in the parallel negotiations regarding the main contract with third parties; fourthly, the parties wish to set rules for further negotiations; fifthly, the need to coordinate the allocation of costs in case of failure of the negotiations and agree on the amount to be paid if the party refuses to conduct further negotiations[10].

[9] V.A. Vasilyeva, *Problems of civil regulation of relations on the providing of intermediary services [monograph]*, Ivano-Frankivsk 2006, p. 409.

[10] I. Yaremova, *Some features of the the preliminary contract, issues its application*, [in:] *Current Issues of state in Ukraine through the eyes of young scientists*, 2009, p. 237–239.

Thus, the preliminary contracts should be distinguished from other related structures, used in practice, such as contract of intent and general (framework) agreements and, in fact, from the offer itself. In this regard, the Civil Code of Ukraine (Art. 635) and the Commercial Code of Ukraine (Art. 182) indicate that the contract of intent (letter of intent, etc.) if there is no will of the parties to grant him the strength of the preliminary contract, is not considered a preliminary contract and does not create any legal consequences. Other words, the contract of intent only records the desire of the parties to enter the contractual relations in the future. However, the contract of intent does not create any rights and obligations of the parties. Therefore, the refusal of one of the parties to sign the agreement provided in the contract of intent does not involve her into any legal consequences and can only affect her reputation. Thus, the legal value of the preliminary contracts and contracts of intent (protocols of intent) has significant differences: the first is dominated by obligations, and the latter shows only intention of the parties[11]. Thus, the preliminary contracts and protocols of intent must be distinguished from one another by the degree of legal connectedness of their parties. The protocol of intent captures attempts, wishes, plans, but does not imply the intent of the parties to consider them legally bounded[12].

Special attention should be given to the question of the guilty party liability for unjustified deviation from the conclusion of the main contract. In accordance with the Civil Code of Ukraine, the party unreasonably evading main contract provided by the preliminary contract must compensate the other party for damages caused by the delay, unless otherwise is provided by preliminary contract or acts of civil law. At the same time, the Commercial Code of Ukraine establishes the right to demand the other party to sign the contract in court. Apparently the Civil Code of Ukraine and the Commercial Code of Ukraine differ in regulating the consequences of unjustified evasion to conclude the main contract.

[11] A. Klimenko, *Preliminary agreement in civil relations: Theory and Practice: Dis. ...* Candidate. Legal. Sciences: 12.00.03, Kiev 2010, p. 213.

[12] I. Yaremova, *Some features of the preliminary contracts, issues of its application*, [in:] *Current Issues of state in Ukraine through the eyes of young scientists*, 2009, p. 237–239.



The peculiarity of the preliminary contract is the unity of contractual parties as the parties of the preliminary contract can only be parties of main contract. The intention to enter the main contract by a party which is not the party of the corresponding preliminary contract automatically deprives preliminary contract to be classified as such.

Key task of the preliminary contract is that it should provide (stabilize) the relationship between the parties to conclude the main contract, guarantee a real opportunity in a certain amount of time to acquire the rights due to the same conditions that existed at the time of signing the preliminary contract, even when and if one of the parties lost interest in such a legal relations.

# VARIA

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# THE APPLICATION OF GENERAL PROVISIONS ON OBLIGATIONS TO MAINTENANCE OBLIGATIONS[1]

## The relation between general provisions on obligations and maintenance obligations

We can see the dynamics of the society in everyday life situations, but it is more apparent in the case of marriage between men and women. All research in this area points to a rising number of divorces and a decreasing number of marriages, while more and more couples prefer unmarried coexistence. In contrast the legislation in this area is still rigid and has seen little significant change, despite numerous amendments to the Family Act (a. № 94/1963 Coll., hereinafter "FA"), and despite a completely new private law in the new civil Code (a. № 89/2012 Coll., hereinafter "CC"), which nowadays includes family law.

New Civil Code continues to offer no resolve in regards to the problems of single-parent families, e.g. a legitimate defence against non-payment of maintenance. One of the possibilities of the defence could be the interest of maintenance. There are no legal provisions that prevent the application of the interest on late maintenance payments[2]. Despite the fact, that maintenance is monetary performance, the use of the interest under the art. 1970 CC[3] in this case is a contro-

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[2] L. Chalupa, *K otázce úroků z prodlení v soudních sporech. Právní rozhledy*, 1998, č. 9.

[3] Art. 1970 CC: After a debtor who is in arrears in repaying monetary debt, the credi-

versial issue. Yet, it is one of the legal sanction-incentive mechanisms for enforcing payments of a monetary commitment[4]. The preventive effect on the debtor *ex lege*, which interest on late payment causes, is the target and should be met in the case of maintenance obligations of the debtor.

The aim of this paper is to analyze the problem of the application of general provisions on obligations to maintenance obligations, namely the application of default interest at the legal obligation of maintenance obligations.

## The interest of the maintenance

To understand the issue it is necessary to explain the concept of maintenance. This represents in the narrow sense of the word itself the nutrition of the entitled person, but also the satisfaction of other tangible or intangible needs[5]. Therefore, it is a fulfillment of a property nature, but it is not always monetary performance. The maintenance can be characterized as a special kind of performance that can be distinguished on monetary payments (monetary performance of the maintenance is usually provided by the court's decision when deciding on the maintenance) and non-monetary performance (e.g. providing housing etc.)[6].

Legal interest on late payments is set by the art. 1970 CC. The specific level of interest is then determined by the government decree[7]. The provisions concerning interest on late payment is regulated in Part Four of the Civil Code dealing with the regulation of the relative property rights (obligations), unlike the maintenance, which is located in the Second Part of the Civil Code containing the family law.

tor who has duly fulfilled its contractual and legal obligations require payment of default interest, unless the debtor is not responsible for the delay.

[4] J. Šilhán in: M. Hulmák (ed.), *Občanský zákoník V. Závazkové právo. Obecná část (§ 1721–2054). Komentář*, 1. vydání, Praha: C.H. Beck 2014, p. 1051.

[5] D. Kovářová, *Vyživovací povinnost po rekodifikaci*, Praha 2014, p. 29.

[6] Z. Králíčková in: M. Hrušáková, Z. Králíčková, L. Westphalová, *Občanský zákoník II. Rodinné právo (§ 655–975). Komentář*, 1. vydání, Praha 2014, p. 1035.

[7] The government decree n. 351/2013 Call.



Despite this fact, in accordance with the art. 11 CC[8], a general provision on the termination of obligation (including the provision of debtor in default with the performance and therefore including the interest) shall apply proportionally also to the termination of other private rights and obligations, which includes the maintenance. The art. 11 CC elaborates the art. 1723 CC, which defines that provisions for liabilities that arise from contracts, shall apply mutatis mutandis to liabilities arising under any other legal matters, and thus have to also apply on the maintenance. In connection with the payment of maintenance, the legal commitment relationship should also be discussed which according to the art. 1721 CC[9] the right to the creditor against the debtor to specific performance and the debtor has duty to fulfill the obligation that satisfies the debt. This obligation arises from „the other facts stated in the law" (parenthood is a typical example of such other facts), to which the art. 1721 CC reffered.

To claim interest on late payments, it must fulfil the following conditions:

- it must be a monetary debt,
- the debtor is in default,
- the debtor is liable for the delay,
- the creditor has fulfilled its obligations.

In this document only the first two conditions will be dealt with, as these are the only areas that can be discussed more generally. The other two conditions should be assessed specially in every single case (if the debtor is liable for the delay, if the creditor has fulfilled its obligations).

The provision of the art. 1970 CC expressly states that the default interest can be claimed only for debtors who are in default on monetary performance. Therefore it can be concluded from the above-described characteristic of maintenance that default interest cannot be applied on every case of maintenance, but only in the situation where the maintenance is the monetary performance. Maintenance representing non-monetary payments from its very nature cannot be the

[8] General provisions on the creation, modification and termination of rights and obligations of the obligations in Part Four of this Act shall apply mutatis mutandis to the creation, modification and termination of other private rights and obligations.

[9] Commitment of the creditor against the debtor the right to certain transactions as the claim and the debtor has an obligation to the fulfillment of this right to satisfy the debt.

subject of interest of maintenance. For these cases there are other mechanisms of sanction (e.g. damages)[10].

A default interest should be reckoned from the date of the default – this means the day after the due of a specific monthly maintenance[11] (the day following the day when the debtor had to perform)[12]. Maturity of maintenance is usually determined in the judgment imposing the obligation to maintenance. The judgement becomes enforceable when the debtor does not fulfill obligation within a certain maturity date.

The default interest should be applicable on the maintenance also without specifying it in a particular judicial decision since the maintenance obligation arises legally, without any further[13]. The judicial decision, which imposes a mandatory duty to fulfill the maintenance, has a declaratory nature and thus it only authoritatively states that the maintenance obligation exists. The maturity of the maintenance is even established by law in the art. 921 CC so that maintenance is always payable one month in advance (unless stated otherwise). Therefore the outcome could be that the designated maturity date is the last day of the month preceding the month in which the maintenance is to be paid. No special contractual arrangements are required for the application of default interest and the sanctions start directly from the law[14].

Court jurisprudence, however, rejects this view in principle and it notes that the debtor does not know the extent of the maintenance and they do not know the exact day of the maturity of the maintenance[15].

Therefore the interest of maintenance should be possible with a subsequent judicial decision, where the specific amount of maintenance per month and its maturity will be determined. However, this

[10] J. Šilhán in: M. Hulmák (ed.), *Občanský zákoník V. Závazkové právo. Obecná část (§ 1721–2054). Komentář*, 1. vydání, Praha 2014, p. 1055.

[11] According to the art. 921 CC nutritional be implemented in regular doses and is always payable one month in advance.

[12] Z. Králíčková in: M. Hrušáková, Z. Králíčková, L. Westphalová, *Občanský zákoník II. Rodinné právo (§ 655–975). Komentář*, 1. vydání, Praha 2014, p. 1049.

[13] M. Hrušáková, Z. Králíčková, L. Westphalová, *Rodinné právo*, 1. vyd., Praha: C.H. Beck 2015, p. 205.

[14] J. Šilhán in: M. Hulmák (ed.), *Občanský zákoník V. Závazkové právo. Obecná část (§ 1721–2054). Komentář*, 1. vydání, Praha 2014, p. 1055.

[15] The judgement of regional court in Prague from the day 19.5.2011, č. j. 28 Co 167/2011-79.



creates a situation that even though an obligation to provide maintenance arises *ex lege*, as well as its maturity is determined *ex lege*, the effects associated with the maturity of this obligation (ie. the entitlement to default interest) arise after the courts decision[16]. This paper precieves this situation as unacceptable.

Judicial practice initially did not accept the default interest of maintenance under any of the above mentioned circumstances. Its position was based on the argument that it is necessary to take into account the special nature of maintenance, especially the immediate boundedness to personal relationships. According to the opinion of the Constitutional Court, this has to be the reason for a specific criminal penalty for late payment of maintenance, which justifies the impossibility to use the civil legislation of default interest[17]. This argument cannot be accepted because the aim of the criminal proceedings is indeed to penalize the debtor, but not the compensation of creditor as the default interest aim to[18].

The situation was similar in the Slovak Republic. The Slovak amendment to the Family Act[19], however, with effect from 15.6.2013 regularize interest on late payment of maintenance, which could be an inspiration to our legislation. Paragraphs were added to art. 76 of Slovak family law which allow in case of delay with the performance of maintenance set by the courts decision to demand the default interest. The explanatory report of this amendment further states that the default interest of maintenance should be part of the claim which executors would also be able to recover directly with the maintenance[20].

The Regional Court in Prague[21] found the same direction. In its decision, the court did not admit the default interest of the maintenance, but only because the maintenance has not been determined by the court's decision and the debtor did not know the specific amount of maintenance and its maturity. Although this is a step in the right direction, the question of interest remains questionable and the solu-

[16] Consistently the art. 76 a. № 36/2005 Call. of Slovak republic.

[17] The judgment of Constitutional Court from the day 2.6.2006 sp. zn. I. ÚS 399/05.

[18] P. Schinnenburgová, V. Cidlina, *K určování výše výživného. Právní rozhledy*, 2013, n. 7.

[19] A. № 36/2006 Call. Slovak family law.

[20] The explanatory report to the art. 76 family law.

[21] The decision of the regional court in Prague from the day 19.5.2011 č. j. 28 Co 167/2011.

tion could be the explicit provision on default interest of the maintenance in the Civil Code as well as in the Slovak legislation.

### The outcome and the consideration *de lege ferenda*

Due to the greater legal certainty, this issue would be appropriate to modify by the separate provision that would explicitly allow interest on maintenance and set out the conditions for its implementation.

One of the proposed solutions is to decide on the request of the plaintiff about conditional payment of default interest already in the operative part of the judgment. It would be an exercise of the right to interest even before the actual delay. In this case, however, the creditor would be burdened with further procedural steps. Therefore, the treatment that is in Slovak family law seems more appropriate. The executor may provide the enforcement order, even though the obligation to pay interest is not directly set in the court decision. Similar legislation would certainly be a motivational tool for many debtors from the maintenance.

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# DISPOSITION WITH THE HUMAN BODY IN PRIVATE LAW RELATIONS: RECENT TRENDS AND RECOMMENDATIONS

## Introduction

The legal status of a human being, meaning human body and human body parts, biological substances, genome, and products of the human body, is being regulated by several branches of law – foremost Constitutional Law and International Law (the human rights issues[1]), Administrative Law (e.g. issues such as healthcare services provision or funeral services[2]), Criminal Law (protection of life and limb[3]), and finally the Civil Law, respectively, in broader sense, private law[4]. In this paper, attention is paid mostly to the private law aspects of human body status, in the context of new Civil Codes being enact-

[1] A. Roosendaal, *Implants and Human Rights, in Particular Bodily Integrity*, [in:] *Human ICT Implants: Technical, Legal and Ethical Considerations*, ed. M.N. Gasson, E. Kosta, D.M. Bowman, The Hague 2012, pp. 81–96; E. Kosta, D.M. Bowman, *Implanting Implications: Data Protection Challenges Arising from the Use of Human ICT Implants*, [in:] ibidem, pp. 97–112.

[2] T. Gábriš, L.Tobiášová, *An Introduction to Public Health Law*, Bratislava 2015, p. 138 ff.

[3] P. Kádek, *Niekoľko poznámok k trestným činom proti životu a zdraviu v zdravotníctve podľa slovenského Trestného zákona. (A few notes on offences against life and limb in healthcare services under the Slovak Criminal Code.)*, "Karlovarskáprávní revue" 3/2010, pp. 85–103.

[4] C. Roth, *Eigentum an Körperteilen Rechtsfragen der Kommerzialisierung des menschlichen Körpers*, Berlin 2009; I. Goold, M. Quigley, *Human Biomaterials: The Case for a Property Approach*, [in:] *Persons, Parts and Property: How Should We Regulate Human Tissue in the 21st Century?*, ed. Imogen Goold, Oxford 2014, p. 231 ff.; L.B. Moses, *The Problem with Alternatives: The Importance of Property Law in Regulating Excised Human Tissue and In Vitro Human Embryos*, [in:] ibidem.

ed in Central and Eastern Europe, especially in the Czech Republic (already enacted and effective) and in the Slovak Republic (currently in the process of preparation). Legal approaches thereby vary to a great extent – the prevailing theories operate with the following legal classifications of the objects of human origin:
a) objects *extra commercium* and *sine domino*
b) parts of the human personality protected by personality rights
c) *sui generis* objects
d) hybrid of the above categories[5].

## Theoretical background

The exclusion of the human body from legal disposition, at least with respect to a free man (non-slave), was a principle known already to ancient Romans. The Middle Ages with a strong influence of Christianity maintained this position. Even the modern age legal thought, specifically in the person of Immanuel Kant (1724–1804), took the view that one can not dispose of his own body[6]. Kant is even claimed to have rejected organ donations, since these can be considered as contrary to the maxim of self-preservation, thus being immoral[7]. However, the twentieth century advances in science and medicine have brought about a reconsideration of these issues, whereby the conclusions are now partially different from Kant's position, and closer to libertarian views on human body[8]. Organ donations are not perceived as incon-

[5] Cf. M.M. Litman, *The Legal Status of Genetic Material*, [in:] *Human DNA: Law and Policy*, ed. B.M. Knoppers, The Hague 1997, p. 17; D. Nicole, D. Chalmers, R. McWhirter, J. Dickinson, *Impressions on the Body, Property and Research*, [in:] *Persons, Parts and Property: How Should We Regulate Human Tissue in the 21st Century?*, ed. I. Goold, Oxford 2014, pp. 15 ff. In the Slovak scholarship the issue is covered by I. Humeník, *Právna povaha ľudského tela, jeho častí a možnosti dispozície nimi (Legal nature of human body, its parts and possibilities of disposition therewith)*, Available at: http://www.pravo-medicina.sk/aktuality/9/pravna-povaha-ludskeho-tela-jeho-casti-a-moznosti-dispozicie-nimi (accessed on 28 April 2016).

[6] I. Kant, *The Philosophy of Law*, Edinburgh 1887, p. 99.

[7] I. Kant, *Grundlegung zur Metaphysik der Sitten, Frankfurt am Main 1991, On current re-assessment of Kant in this respect*, cf. S.J. Kerstein, Kantian Condemnation of Commerce in Organs, "Kennedy Institute of Ethics Journal" 19, 2009, 2, p. 147–169.

[8] Cf. A. Hudecová, *Libertariánsky pohľad na vlastníctvo ľudského tela (A Libertarian View of the Ownership of Human Body)*, "Filozofia" 66, 2011, № 5, p. 491.



sistent with the maxim of self-preservation any longer, especially when it comes to donating one of the paired organs, or *post mortem* transplantations. However, the jurisprudence still witnesses a lively discussion as to the legal character of organ donations in terms of private law[9] – namely whether the organ donation represents a deed of gift, which would mean that donated substances, tissues or organs are to be treated as things, or whether such donations are solely regulated under public law[10].

## Human Body as a Thing? Judicial Practice and Legal Theory

Generally, the Slovak and Czech legal scholarship considers human body as not being a thing in legal meaning, this view being shared by the contemporary Slovak and Czech case-law based on the common Czechoslovak Civil Code from 1964 (in the Czech Republic replaced by a new Civil Code from 2012 in the meanwhile). For example, in a judgment of the Czech Supreme Court, 22 Cdo 2773/2004 on opening of a tomb, the Court stated: "*The appellate court also observes that, already under § 285 of the Civil Code of 1811, which stated that everything that is different from a person and serves to be used by the people is a thing in legal sense, a dead human body was not considered a thing for precisely those reasons. Additionally, page 7 in the Commentary to the Czechoslovak Civil Code, published by legal bookstore and publishing house V. Linhart in Prague in 1935, states that the human body even as a corpse is not a thing if one is able to behold certain deceased person in it (that far personal rights protection is provided to the heirs of the deceased). Once it is not possible, the corpse is a thing (e.g. the corpses from the past, like a mummy or pre-historical findings). ... There is no need even today to deviate from this interpretation of the concept of a thing, when the valid Civil Code in its § 118 contains no definition of the term thing and expressly regulates only the*

[9] Cf. C. Roth, *Eigentum an Körperteilen Rechtsfragen der Kommerzialisierung des menschlichen Körpers...*

[10] L.B. Moses, *The Problem with Alternatives: The Importance of Property Law in Regulating Excised Human Tissue and In Vitro Human Embryos...*

*protection of personality rights of individuals after their death, in that in § 14 it states that the right to pursue remedies for the personality protection of a dead individual belongs to the spouse and children, and in the absence thereof, to the parents of the deceased*". This means that, in general, human remains are not considered a thing (provided they are still identifiable as a specific person and there are relatives that can invoke the personality rights protection of the deceased).

Similarly, in a judgment of the Czech Supreme Court, 22 Cdo 685/2005, where an applicant requested a court to order a defendant to hand over to the applicant urns with remains of parents and wife of the applicant, the Supreme Court first summarized the arguments of the Court of Appeal as follows: "*The Court of Appeal stated that the urns are in accordance with § 118 et seq. CC movable things; remains stored in them are not things in the legal sense, though. Concerning those, there is no question of property rights, and manipulating with them must follow the Act ... on funerals ...*" The Supreme Court subsequently confirmed that "... *remains of the deceased cannot be a subject of civil law relations (and of ownership claims) ... Applications searching for a decision concerning the disposal with buried or cremated remains of deceased persons cannot be accepted; such claims are not based on any provision of the Civil Code or other private regulation which would create an entitlement to a person to decide on a relocation of the remains*".

This issue was similarly coped with in the resolution of the Slovak Constitutional Court I. ÚS 206/2012-17 in a case of a complainant's action filed originally before a District Court requesting the Court to order to the Office for Healthcare Supervision to hand over to the complainant the biological substances of her deceased mother – samples and smears taken. The first instance District Court found that on the part of the applicant as well as of the defendant there was a lack of active and passive competence to stand before the court in this matter. The applicant had namely not demonstrated that the biological material – samples and smears collected belong to the applicant, respectively that the applicant has any authorization to manipulate with the samples, nor that the defendant detained the biological material without legal grounds. Lack of *locus standi* of the applicant was supported by the District Court in that the dead body, its separated parts and samples taken from it are not to be regarded as a thing and cannot be a subject of ownership rights or of free disposal. These objects are namely *sui generis*, distinct from the concept of a thing; in case of the whole dead body it is an object different from the notion of a person, whereby disposing with a dead body and its separate parts is governed by special regulations governing the issues of piety, respect for the body, and regulating the disposition with the dead body or with parts of the body. These objects do not enjoy a legal status under § 118 and § 119 of the Civil Code (Act № 40/1964 Coll.) on movable and immovable things, the Court concluded. On appeal against this District Court decision, the Regional Court as a Court of Appeals found that the applicant's appeal was unfounded. Finally, the Constitutional Court similarly considered that the lower court had properly, clearly and logically explained the reasons why biological material taken from a human body can not be (and is not), for its nature itself, an object of civil relations, and can not be subject to property rights and free disposal. Disposition with such material is strictly regulated by special – public law – regulations.



In Czech and Slovak legal scholarship, this argumentation of the judicial practice is labelled as meaning that the human body is considered an object *extra commercium* and *sine domino*. The status *extra commercium* is confirmed also by the Charter of Fundamental Rights of the EU, which in its Article 3(2) point c) contains a prohibition on making the human body and its parts as such a source of profit. Despite of that, still, the position of various authors and national legal systems differs as to whether human body and biological substances are a "*res*", thing, and whether it is really a *sine domino* object (without an owner). E.g., in the territory of Slovakia, prior to 1950a dead body was considered a thing, albeit *extra commercium* and *sine domino* – this was under the Hungarian law applicable in Slovakia, influenced strongly by German legal scholarship[11].

This issue was recently explicitly regulated in the new Czech Civil Code № 89/2012 Coll. (hereinafter referred to as the NCC) in its § 493, where the NOC maintains the view that the human body and its parts are not things. This principle is essentially consistent with the

[11] Cf. T. Gábriš, *Vec v právnom zmysle: ľudské telo. (Things in legal sense: human body.). In: Občiansky zákonník 1: komentár. (Civil Code 1: Commentary)*, Praha 2015, pp. 734–743.

previous Czech and Slovak case-law, but at the same time it is contradictory to the law valid in the territory of Slovakia prior to the introduction of the first Czechoslovak Civil Code of 1950, and partly also contradictory to the legislation in force in the Czech territory until 1950, where it was determined that the body becomes a thing when it is not possible any longer to behold in it "*a body of a certain deceased person*". The NCC namely does not contain any such provision. Still, the NCC knows an exception to the fact that the human body and its parts are not things. Under § 112 NCC, hair and other painlessly and without anaesthesia severable body parts, that tend to restore in a natural way, are to be considered movable property, and can be handed over to another, even for remuneration. Still, it may be controversial in this respect, what status should human teeth enjoy under the NCC, since they are often not separated painlessly and adult teeth do not renew naturally.

Concerning prostheses, the NCC considers these – after separating – to be a thing. Before separation, they are considered a part of the body, though. However, an issue can arise here with respect to interconnection between a human body and external devices (artificial ventilation, but also interconnection with a computer[12]). Such external devices can obviously not be considered prostheses or a part of a human body, especially if being only a temporary solution within the healthcare provision. As an inspiration, jurisprudence in Slovakia (and Hungary) prior to 1950 insisted that artificial parts of the body must be physically connected to the body and therefore must physically represent a part of the human body – obviously, linking a body to a remote computer does not meet this condition and the computer should thus only represent a thing, not being a part of the human body.

## Disposing with the Human Body?

Departing now from the issues of definition of a thing and moving to the regulation of disposition with the human body and its parts,

[12] A. Roosendaal, *Implants and Human Rights, in Particular Bodily Integrity...*, pp. 81–96; E. Kosta, D.M. Bowman, *Implanting Implications: Data Protection Challenges Arising from the Use of Human ICT Implants...*, pp. 97–112.



these issues are addressed mostly in the norms of public law – in the Slovak Republic in particular in the Act № 576/2004 Coll. on Healthcare and the Act № 131/2010 Coll. on Funerals.

The Healthcare Act in its § 35 et seq. regulates extraction, testing, processing, preservation, storage or distribution of organs, tissues or cells for transplantation or transfer purposes, and for scientific research purposes. In principle, the maxim is introduced that organs and tissues should be taken, *if* possible, from dead persons, i.e., cadavers, as the extraction from bodies of living donors is associated with a particular risk for the potential living donor[13].

Similarly, disposing with a dead body is also covered by public law in Slovakia –the Act № 576/2004 Coll. on Healthcare (especially § 37 and 41 et seq.) and the Act № 131/2010 Coll. on Funerals. The latter Act specifically regulates the competences of state administration bodies and municipalities, rights and duties of individuals, natural persons-entrepreneurs and legal entities in relation to manipulating with the human remains (dead human body before burial) and human relics (after burial), providing funeral services, cremation services, burial sites, and providing embalming or other preservation of human remains. These rules, however, do not provide for any instruction towards other disposition with a human body – for example, plastination for the purposes of exhibiting the body[14], or the use of skulls in theatres, etc.

In terms of private law, similarly, any express provision on the possibilities of disposing with the human body and its parts in life (*inter vivos*) or after death is entirely lacking in the Slovak legal system. The Czech NCC, in contrast, in its §§ 111–117 provides now expressly for the possibility of disposal with the body and its parts in life and for the case of death, and also allows for deciding on burial. The limit is only the dignity, public health, and provisions of special (public law) regulations, in particular the Act on funerals.

[13] P. Kádek, *Súčasné dimenzie právnej zodpovednosti v medicíne a zdravotníctve. (Current dimensions of legal liability in medicine and healthcare services)*, Bratislava 2014, pp. 151 ff.

[14] Cf. T. Kotrlý, *Tělo bez duše, rakve a rubáše (A body without a soul, coffin and shroud)*, Available at: http://jinepravo.blogspot.sk/2009/11/tomas-kotrly-telo-bez-duse-rakve-rubase.html (accessed on 28 April 2016).

## German Approaches to Dead Bodies and their Disposing

Taking an example of a foreign legal system for comparative purposes, German law[15] being close to the east-central European legal systems considers a dead human body to be a thing, similarly as it was the case in the territory of Slovakia prior to 1950. Still, one can not appropriate nor freely dispose with it, since this is prevented by personality rights of the deceased person, respectively by a specific legislation on piety as recognized by the German Constitutional Court under a headline of *post-mortem* human dignity. However, at the same time the Court acknowledged that if a person expressly wishes to deliver her body to a certain institute, it is possible to do so, even with the possibility that the institute can further dispose with the body. The institute does not own, however, but only possesses the body, whereby the possession of a dead body is not unlimited in time; it is limited by the purpose of the use of the body. Should the body no more serve the scientific or educational purposes, it becomes subject to provisions on funerals, the application of which was previously suspended in order to use the body for the specified purposes. (Similarly, in Slovakia, under § 3(5) of the Act on Funerals № 131/2010 Coll., it is allowed to make use of a dead body (solely) for scientific, therapeutic, preventive or teaching purposes – in these cases the obligation to bury the body is suspended).

After the decomposition or cremation takes place, under the German law, human remains (relics) become things that enjoy no special status in terms of personality rights any longer. Hence, in principle, German law recognizes personality rights of the deceased only until the body is identifiable as a specific person. The same applies also to a body where the decomposition process was hindered by mummification in ancient times or through a natural process – here it is usually not possible to identify the remains with certainty, nor are there any entitled subjects that could invoke personality rights protection with respect to these bodies or remains. In both cases one can speak of human remains (or relics) where the period of piety has expired.

[15] C. Roth, *Eigentum an Körperteilen Rechtsfragen der Kommerzialisierung des menschlichen Körpers...*, p. 135.



The period of piety, however, is not perceived uniformly in German jurisprudence. According to some opinions, this is a special period prescribed in the regulations on funerals (in Slovakia this period is at least 10 years, according to § 19(3) of the Act on Funerals № 131/2010 Coll.), other opinions propose it is the duration of intellectual property rights. Naturally, there is also the possibility of taking into account the time period while there are any people alive who may claim the personality rights of the deceased person, or the time period when the remains are still identifiable as a specific person. Finally, some other opinions allow for an extension of time period in case of corpses in fallen soldiers' monuments, and in case of prominent personalities[16].

As regards the so-called plastination of dead bodies, there is a lively debate in German legal scholarship as to whether the plastinated bodies are still human remains (dead bodies before burial) or rather products created by processing. Personality-rights protection might be weakened here due to the fact that the plastinated bodies are usually depersonalised -particularly deprived of skin. According to some opinions such exhibits should therefore be treated as any other depersonalized human remains (or relics), for example the ashes of a deceased, or decomposed bodies. The national funeral legislation should regulate whether such ashes or otherwise depersonalized bodies must be buried, or may be disposed with in other ways – for example through processing the ashes into a diamond, a painting, or similar. However, even after such processing, should one thereafter bring the products to a State under the laws of which human remains or relics must be buried, again a question arises whether such products are to be buried or not. It might be claimed here that after processing these are new objects different from the remains (relics); and additionally, it is surely difficult to identify the origin of the product – particularly in case of jewellery or of a painting.

[16] Ibidem.

## Common Law Approaches to Dead Bodies and their Disposing

In the common law countries, both legislature as well as judicial practice pay attention to the issues of private-law status of human body and to possibilities of disposing withthe dead bodies. Thereby, some rules and decisions might be perceived as being contradictory to approaches taken in continental Europe. However, in general, also in the common law systems, the general axiom is that the human body is not an object of property rights and is not a thing in the legal sense (as stated in older cases *R v. Sharpe* in 1857, *Williams v. Williams* in 1882, and *R v. Price* of 1884[17]). Still, an Australian court in case *Doodeward v. Spence* acknowledged already in 1908 that a two-headed baby body serving after adjustments as an exhibit item can be regarded as an object of property rights[18]. Processing of human body thus in fact constitutes an exception under which a human body can be regarded as a thing –in particular in case of teaching aids or museum exhibits. Similarly, in case of *AB and others v Leeds Teaching Hospital NHS Trust,* a British court in 2004 acknowledged that a processor of a dead human body into a teaching aid had invested his own processing skills and artistic talents into the processing, which made the final product the property of the processor. Another British court ruled similarly in case of *R v. Kelly & Anor* from 1999, concerning property rights to parts of human bodies intended to be used in educating future surgeons[19]. However, even under this case law, processing of human body, respectively of human remains or relics should not be done in breach of human dignity, ethical interests of survivors and public (as laid down in Slovakia in § 4(1) point f) of the Act on Funerals № 131/2010 Coll.), or against the will of the deceased or authorized persons, especially should it be possible to identify the deceased after the processing.

[17] I. Goold, M. Quigley, *Human Biomaterials: The Case for a Property Approach...*, p. 231 ff.

[18] L.B. Moses, *The Problem with Alternatives: The Importance of Property Law in Regulating Excised Human Tissue and In Vitro Human Embryos...*, p. 203.

[19] I. Goold, M. Quigley, *Human Biomaterials: The Case for a Property Approach...*, p. 231 ff.



## Recommendations on Private-Law Status and on Disposing with Dead Bodies

Returning back to codification processes within private law in east-central Europe and specifically in Slovakia, in terms of private-law status and disposition with human body it was already mentioned that under the relevant case-law the principle applies in Slovakia that living human body and also dead human body (remains, relics) are not considered things (since 1950), they are *extra commercium* and *sine domino*, and should serve primarily for medical and research purposes, unlike in the Czech Republic, where some body parts can be traded even for money, provided they are renewable and severed without causing pain.

Albeit the Czech model may not be the perfect one, *de lege ferenda* it is surely desirable to adjust the status of human body and its parts (and of biological material in general) as well as disposition with these objects within the codifications processes in each east-central European country – either expressly, or at least through reference to special laws, albeit laws of a public-law nature.

With respect to a new **private-law regulation**, based on the above comparisons, *de lege ferenda* the following options seem to be the most relevant and advisable:

1. in accordance with the existing case-law and the new Czech Civil Code the first option would be to exclude body and its parts, even after separation, from the definition of things, with the possible exception of separable and recovering parts, including teeth;
2. the second option is to consider separated body parts and dead human bodies as things (as it was in Slovakia prior to 1950 and as it is currently in Germany), but only *sine domino* and *extra commercium* (commercialization is prevented also by the international legal instruments), with a possible exception of separable, recovering parts, teeth, and possibly also with the explicit exception of products made from corpses and bones, which can no longer be recognized as an individual personality (e.g. different teaching aids, but also museum exhibits) – those could be even recognized as *cum domino* and *in commercium*, while respecting human dignity;

the third option might be a compromise consisting in a principle that dead bodies or separated body parts are not things as long as personality rights are applicable, respectively within a specified time-limit. Only the separable, recovering parts, teeth, as well as products made from human remains or relics, which can no longer be recognized as an individual personality (e.g. different teaching aids or museum exhibits) and remains after a set period (when personality rights cannot be invoked any longer), could be considered a thing, even a thing *cum domino* and *in commercium*, while respecting human dignity.

In all cases, the possibility to decide by the deceased in advance on burial or other treatment of the body should be allowed and recognized.

**The most preferable thereby appears to be the option number three**, consisting of the following partial elements offered schematically:

a) **a time-limited *sui generis* regulation of the status of human body and body parts– during the decomposition time, time period of personality rights protection or prior to processing into a depersonalized product,**
b) **with new private-law options to decide on the fate of the body, body parts, remains or relics, both during life and after death, while such treatment should not be contrary to human dignity, ethical values of survivors and of the public, public health, respectively it should not constitute any interference with the private life or family life,**[20]
c) **with additional public law regulation on manipulating with dead bodies** (allowing for e.g. permanent disposal in cryonic chambers), at the same time regulating options for processing the remains or relics into new products, while observing human dignity (depersonalized plastination, production of relics of saints, images painted with ashes of a deceased, or diamonds created from the ashes of the deceased). Thereby it is also advisable to resolve through public law rules the particular issue of manipulation with a human body by institutions that were entrusted the dead bodies (mostly scientific institutions, but also museums or companies freezing dead bodies or performing plastinations). The aim may not necessarily be to construe the right of ownership to the body for such entities; a special right (under public law) to hold and dispose with the body for the intended purpose while observing human dignity might suffice, suspending the public law obligation to bury the remains, **whereas**
d) **treating human remains or relics as a thing *cum domino* and *in commercium* – after the set time period (decomposition time, time period of personality rights protection) or after their processing into a depersonalized form should be laid down by law –** which should even be acceptable under the Charter of Fundamental Rights of the EU, since the Charter only prohibits making the human body and its parts "as such" a source of financial gain. Using the words "as such" might thereby mean that when processed, it could be acceptable to commercialize these. The Charter also uses the words "human body" in this provision, which again seems to suggest an individualized human body rather than a depersonalized human relic (especially if processed into jewellery or painting).

[20] The Constitutional Court of the Czech Republic in case I. ÚS 2477/08 confirmed that dead human bodies and their place of rest fall under piety protection, which is a part of the right to family life.



## Conclusions

The legal status of human body, body parts, genome and biological substances and disposing with these poses various challenges to private law in continental as well as in common law system. In general, it is often accepted that human body and human body parts are not considered things in the legal sense (with the exception of Germany, and also Slovakia prior to 1950), but rather enjoy a *sui generis* (of its own kind) status. Exceptional is the approach of some common law jurisdictions, recognizing a sort of property-like status of some bodies and body parts, especially when modified into a product. Even in continental Europe, the same might be recognized with respect to human remains or relics, if de-personalized, such as exhibited artefacts in museums or objects in special human-body exhibitions. It is therefore recommended that any new private law legislation explicitly reflects this approach to the above mentioned objects and provides for a *sui generis* protection of body and body parts while individual-

ly recognizable, but allowing for deciding on the fate of the body by the deceased person in advance, as well as allowing for manipulation and sale of remains/relics or products after being depersonalized. Public law legislation should thereby explicitly allow for various types of manipulation with dead bodies (freezing, processing) while observing the necessary standards of piety. The public and private law regulation should hence be closely interconnected in order to guarantee the respect for human dignity of the deceased persons.

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# SOME ISSUES OF RECOGNITION AND CONTESTING PATERNITY IN UKRAINE

In Ukraine and abroad there is a number of scientific achievements about the minors' rights to be juridically protected, and they are generally related with researching the study of Family Law and due to determining the child's family rights, and also defining the sense and nature of a child's personal moral and property family rights. When regarding procedural forms to protect these rights, procedural peculiarities of the case to be prepared and to be heard at litigations that can arise because of family relations with minors, especially in the cases of defining paternity, in the study of civil Procedural and Family Law in Ukraine these aspects of the problem remained unnoticed by the scientists.

In my mind, the most correct opinion is of the authors who consider it possible to recognize minors as equal participants in a civil process as one of the parties, and it's not contrary to the Procedural law. In civil proceedings, they often define the range of stakeholders rather incorrectly. As a result, this can cause unreasonable contracting or expanding their legal status, as well as causeless and illegal judgement in a civil case. That's why quite important phase of civil proceedings is the judge's identification of the individuals, which are eligible to participate in the case, and the individuals, which due to the law are entitled to apply to the courts.

Abusing a civil trial is an act of implementing such constitutional right as the right to be protected in the courts (Article 55, Constitution of Ukraine) and the right to apply for protection in the courts confirmed in Article 3 in Civil Procedural Code of Ukraine.

In the cases about paternity recognition and due to the Article 128, Ch. 3 in Family Code of Ukraine the right to apply to the courts is given to mother; a child's custodian/fiduciary; an individual who brings up a child; adult child and also an individual who considers to be a child's father.

At first sight, the list of individuals, which are eligible to bring a suit in the court concerning paternity recognition, doesn't cause any comments, but these individuals' procedural positions remain controversial. In this situation explained in Article 128, Ch. 3 in the Family Code of Ukraine there is no clear understanding which of the individuals applying to the court is a litigant.

The discussions keep going on this matter in legal literature. There are some scientists who consider mother and a child[1] to be litigants in the cases about paternity recognition, but there are others who consider a child only[2]. There is another group of scientists whose opinion is about any stakeholder[3] to be a litigant. In the theory of civil Procedural Law the parties are different by a specific feature, that is a substantive relation between them. In the case of paternity recognition such relation is confirmed only between a child and his/her father, as the sense of paternity decision means to confirm if there is substantive relations between a child and his/her blood mother and father or there is not such. Meanwhile, when defining the issue about paternity in the courts between a minor and his/her likely father there isn't any legal relationship, but there can be substantive relations between them only after the claim for paternity recognition is satisfied by the court.

The persons participating in proceedings, are granted with a separate legal interest, aimed at resolving the substantive dispute between the parties, the civil procedural legal entities who are implementing the principle of adversarial civil proceedings, in the court may commit certain procedural steps when protecting under the proceedings their rights, freedoms and interests or in cases confirmed by the law the rights, freedoms and interests of others. Being legally enrolled to the range of stakeholders, the persons participating in the proceedings and notifying a specific type of civil proceedings are characterized by: 1) the presence of personal legal interest in the results of reviewing and resolving the civil cases aimed to resolve the substantive dispute between the parties; 2) providing actions aimed at the origin, evolution and termination of civil proceedings (procedural actions)[4].

[1] V. Koshkin, *Judicial confirmation of paternity [Sudiebnoye ustanovlenii otsovstva]*, Sverdlovsk 1972, p. 27.

[2] M. Materova, *Judicial trial of paternity's confirmation [Sudiebnoye razsmotreniye ob ustanovlenii otsovstva]*, Moscow 1982, p. 68.

[3] Ibidem.



The range of stakeholders participating in cases in the proceedings is formed by: 1) the parties (litigant and defendant); 2) the third parties (claiming personal demands of the dispute and do not claim personal demands of the dispute); 3) the bodies and individuals who have the legal right to protect the rights, freedoms and interests of others; 4) representatives of the two and third parties and bodies and individuals who have the legal right to protect the rights, freedoms and interests of others[5].

Based on the judicial practice, most claims for paternity recognition are sued by mothers. Mother, when bringing a suit for paternity recognition or denying the claim of the person considering to be the child's father, acts as the child's legal representative, defending his/her interests and providing his/her subjective rights. Meanwhile, she acts by her own interests, applying for father's part in bringing up and supporting the child, but this interest is naturally indirect.

In our opinion, the right to sue belongs exclusively to the child as the claim for paternity recognition concerns to establish legal relationship between a child born out of wedlock and her supposed father. Here the child should be considered as a potential litigant in the case of paternity recognition. Procedural litigant, who always acts in the child's interests, can be mother; guardian, trustee; a person who support and bring up the child; a person who considers himself a father. The aim of the latter's' participation in the process is to protect personal moral and property rights and interests of the child who is not able to defend their interests him/herself.

Due to Article 128, Ch. 3 in the Family Law of Ukraine the child himself may bring a suit, but only being of age. But the question arise

[4] S. Bychkova, *Participation of the prosecutor in the protection of civil rights by a court // Problems of realization and protection of civil rights [Problemy zdiysnennia ta zahystu subyektiv tsyvilnyh prav]: collection of papers*, Kiyv 2013, p. 103–104.

[5] S. Bychkova, *Civil procedural legal status of persons involved in the case of action proceedings [Tsyvilniy protsesualniy pravoviy status osib, yaki berut' uchast' u spravah pozovnogo provadzennia]*, Kyiv 2011, p. 37.

why the legislator determines only the adult child to be able to appeal to the court.

Based on the traditional view on the child's legal status, the protection of the violated rights and interests is assigned to the legal representatives (parents, adoptive parents, guardians, trustees). However, the statements in Art. 27-1 in Civil Procedural Code of Ukraine basely confirm that minors are fully legal participants in civil procedure and are given both general procedural and special rights and duties. This approach is conditioned by national legislators because of Ukraine's accession to the European Convention in 1996 about implementing the Children's Rights that determine the possibility for the minors to be judicially protected in the courts.

Being a minor the individual can personally provide his/her civil procedural rights and do his/her duties in the court in the cases concerning the relationship in which he/she participates personally (Art. 29 in Civil Procedural Code of Ukraine). That is, such a person possessing legal backgrounds can be a subject to civil legal proceedings. But the court may ask the legal representative of a minor to the case (Ch. 2, Art. 29, Ch. 2, Art. 39 in Civil Procedural Code of Ukraine). This statement proves that minors aged from 14 to 18, defined the subjects of family relations (due to Article 18 of the Family Code) may personally protect their family rights, freedoms and interests in the court. Besides, in the case of underage person's marriage, he/she acquires civil procedural capacity since marriage (Ch. 3, Art. 29 in Civil Procedural Code of Ukraine, Art. 34 in Civil Code). The underage person granted the full civil capacity can acquire civil procedural capacity in the order prescribed by Art. 242–245 in Civil Procedure Code and Art. 35 in the Family Code (... underage person who is registered as the mother or father of the child).

On Kondratieva's L.A. opinion, minor's right to be judicially protected is a subjective right guaranteed by the Constitution of Ukraine and belonged to the minor to protect his/her violated rights, freedoms and interests in civil proceedings. A minor may provide the right to be judicially protected directly in the cases arising from family relationships, in the matter of being at the age of 14[6]. Also, the scientist

[6] L. Kondratieva, *Judicial protection of minors in civil proceedings of Ukraine [Sudoviy zahyst nepovnolitnih osib u tsyvilnomu protsesi Ukrainy]*, Kyiv 2006, p. 14.



motivates the conclusion about the person who has not gained the adult age and defined the subject of fourteen in family relationships, when applying to the court he/she is an individual subject of civil legal proceedings and should have the procedural rights and legal duties of the parties in full.

Taking comparison with the legislation in neighboring countries, Russian Federation as an example, only the adult child may bring a suit in the case of paternity recognition, as well as in Ukraine. At the same time in some US states, a child up 14 may initiate such process.

In the given context and based on the Art. 18 in the Family Code of Ukraine, the child up 14 may personally apply to the court to protect his/her rights (family) or interest in the matter of their violation, rejection and contestation in order to protect the child's rights and interests in family and civil legal proceedings, we propose to amend the Ch. 3. Art. 128 in the Family Code and to replace the phrase "a child who has reached the full age" into "an underage child".

As for the problems of contesting paternity, nowadays civility study is enriching by scientific achievements, characterized by cross-sectoral nature of institutions that attract jurists' attention. These research papers can include studies related to contesting paternity, which can be reviewed as both substantive law (family) and civil procedural law.

A number of studies described such issue as contesting paternity, including Yu.F. Bespalov, G.V. Bogdanova, T.P. Yevdokimova, N.M. Kostrova, Z.V. Romovska, S.Ya. Fursa etc.

It should be noted that according to the current Family Law of Ukraine that's the father's right to contest paternity what is registered in the Birth Record Book. He may do it in the way of bringing a suit in the court with asking to remove information about him as the child's father from the Birth Record Book.

Marital and Family Law, which had ruled before the Family Law of Ukraine became legal, stated that possibility to contrast paternity was restricted to the individual who was registered as the child's father, particularly the opportunity to refute the presumption of paternity at the child's birth in marriage. These restrictions were lied in the fact that, firstly, only the person registered as the child's father might contest paternity. Secondly, contesting paternity could be made only for one year since the person knew or should have become aware of the fact that he was recorded as the child's father.

The Family Code of Ukraine also sets certain limits of contesting paternity, but they are significantly expanded. In the Article 136 in the Family Code of Ukraine the time limits are set about possibility to contest paternity. Thus, contesting paternity is only possible after the baby is born and until he/she becomes full age. Contesting paternity can be provided during this time and only if the child is alive. The child's death prevents the registered person as a father from contesting paternity.

Previously existing Family Law, in our minds, radically restricted the rights of parents, predicting the deadline for bringing a suit to the court about contesting paternity.

According to Part. 1, Art. 56 in the Family Code of Soviet Ukrainian Republic, contesting paternity was limited to the term, that is one year from the date when the person was registered as the child's father, was or should have become aware of the registration of birth. In the Family Code of Ukraine there confirmed the statement about the man's asking to remove information about him as the child's father from the Birth Record Book. So, the time restriction for the claim is not taken.

By its legal nature, the claim about contesting paternity is a sort of protection of moral rights of individuals. Thereby, it is definitely to apply Art. 268 in the Civil Code of Ukraine, Ch. 1, Art. 20 and Ch. 6, Art. 136 in the Family Code of Ukraine, according to which time restrictions are not taken into consideration when requiring protection of moral rights and other intangible benefits. Thus, the request of contesting paternity can be applied at any time.

According to Kostrova's confirming "that it is possible when the mother's husband, who knew he was not the child's father, is not contesting to be the child's father for a long term, the child believes him to be his/her father, gets used to him, and for some reason many years later he decides to contest the matter. Thus, this can damage the child's interests and stability of parental relations". Therefore, in the scientist's opinion, the context in Ch. 1, Article 56 in the Family Code of Soviet Ukrainian Republic about the year-term possibility to contest paternity from the moment when the person was or should have become aware of the record, is used to the child's interest"[7].

[7] Legal proceedings in family cases [Sudoproizvodstvo po semeinym dielam], Makhachkala 1978, p. 24.



Let us not agree with Kostrova. Family Law is based on the principle of priority of the child's rights and interests, but it does not mean their exclusivity. Father's interests also need security and protection. Besides, it is unlikely for the man registered as the child's father, and who missed the deadline for filing a claim for contesting paternity will properly do his parental responsibilities and take care of the child. Fake enforced saving legal relationship between a man and a child, being registered as his/her father, is naturally useless.

As an additional argument we should quote the candidate of legal sciences G.V. Bogdanova: "Denying the time restrictions in a new Family Code of bringing claims proves not only once that the legislator departs from the theory of social paternity and his desire to give greater importance to blood, biological kinship". This suits to general direction of the Family Law ... so some scientists' propositions about the timing of contesting paternity are regarded as false[8]. The ability to satisfy the claims of contesting paternity by the law became dependent on what the reasons were and by what rules the registration of the child's father was made.

Contesting fatherhood (motherhood) is detecting to be the registered father (mother) of the child. Due to the Family Code of Ukraine, a person registered as the child's father has the right to contest his paternity, bringing a claim about removing information about him as a father from the Birth Record Book (Ch. 1, Art. 136 in the Family Code of Ukraine). The person who was registered as the child's father must legally prove the absence of blood relationship between him and the child whose father he was registered. However, detecting the blood kinship is not always a reason to contesting paternity. In some cases, a person registered as the child's father must also prove that at the time of registering the child's birth he did not know that he is not the child's father.

In particular, the person's demand registered as the child's father due to Ch. 5, Art. 136 in the Family Code of Ukraine can not be satisfied if at the time of registering this person was aware that he is not actually the child's father. Thus, a person having blood kinship with the

[8] G. Bogdanov, *Rights and duties of parents and children [Prava i obyazannosti roditeley i dietiey]*, Moscow 2003, p. 112.

child loses the opportunity to prove this fact, because clearly knowing it, he still expressed his will and recognized paternity.

In paternity recognition the Birth Registration Office allows voluntarily recognize paternity on someone else's child. In this case, the principle of the formal origin of the child establishes, which according to the Family Law confirms the rule again that this person's demand to contest paternity can not be satisfied. The person may not be actual child's father, but can not deny this registration.

According to T.P. Evdokimov, such restricted opportunities for contesting paternity was established by the law in the child's interests and relates to the fact that if a person knew he was not the child's father, but nonetheless admit his paternity, he actually voluntarily set for himself parent's rights and responsibilities and in the future he may not refuse from them[9]. In my view, the establishment of such restrictions violate the parents' rights and interests.

Therefore, in my opinion, Ch. 5, Art. 136 in the Family Code of Ukraine should be followed with new paragraphs and quote it as follows: "The person's demands registered as the child's father about contesting paternity can be satisfied if at the time of registering paternity the person did not know that he was not the child's father".

In this context, it is worth considering the opinion of a Russian scientist Yu.F.Bespalov who focuses on the fact that contesting paternity can be regarded only if the court decides that at the time of registering paternity the person did not know that he was not the child's father[10].

According to G. Bogdanova, "if in the trial there will a clash of interests of the two parents, one of which is blood related to the child, and the other is social related that is a clash of two concepts, the priority is given to the kinship".

To prove the above said, we can develop the following situation. A married child is supposed to have been conceived by another man. The mother's husband has no blood kinship with the child, but the mother's husband will be registered officially as the child's according to the presumption of paternity. The child's genetic father is supposed

[9] T. Yevdokimova, *Solution of l court disputes: manual for judges [Razresheniye sudom semeyno-pravovyh sporov]*, Moscow 2008, p. 272.

[10] Y. Bespalov, *Features of legal proceedings in the cases on protection of family rights of the child [Osobennosti razsmotreniya i razresheniya del o zashchitye semeynih prav rebionka]*, Moscow 2008, p. 376.



to appeal to the court for paternity recognition. About this situation A.M. Rabets made her suggestion: "The Court is obliged to define the paternity, if there is some evidence in the case to confirm with certainty the child's origin of the man who is not the mother's husband but the claimer of paternity recognition".

Reviewing the cases of contesting paternity one should bear in mind that according to Ch. 5, Art. 136 in the Family Code of Ukraine the litigant keeps the right to contest the registration (for example, if an application for paternity recognition was brought by threats, violence, or in a state where the litigant was not able to understand his actions or control them)[11].

So today's existing regulatory restrictions on contesting by the man registered as the child's father ("social paternity") and the man who is actually the child's father (blood father) are negative legal phenomena, that can violate both the child's rights and just his/her parents' rights.

[11] A. Rabets, *Family Law [Semeynoye pravo]*, Belgorod 1998, p. 140.

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# THE EMPLOYER'S OBLIGATION TO PROTECT THE EMPLOYEE'S PRIVACY

## Bossing

The English term bossing is currently used also in the Czech Republic to express systematic bullying by the leader. This term, derived from the English word boss or chief, was introduced later than the term mobbing[1], namely in the 90s by the Norwegian S. Kile[2]. In general, the definition of this type of bullying does not differ much from mobbing[3], *since the author of the contribution agrees with Chromý*[4], according to whom it is possible to subordinate bossing under the concept of mobbing in a broader sense. On the contrary Ege[5] does not use the term bossing, but he distinguishes only between the vertical and horizontal mobbing.

In the context of this paper it will be operated with the term bossing, while the emphasis will be placed on bossing performed by the employer, not on bossing by the managerial employee, in order to provide detailed analysis of the means which can be used by this party

[1] The term mobbing was first used within the psychological environment by the psychologist Heinz Leymann in 1982. See: H. Leymann, *The Content and Development of Mobbing at Work*, "European Journal of Work and Organizational Psychology" 1996, roč. 5, č. 2, p. 165.

[2] P. Beňo, *Můj šéf, můj nepřítel?*, Brno 2003, p. 10.

[3] There are many types of acts with the aim to create the hostile workplace for the victim, the characteristic features for this conduct are deceit, concealment, durability and frequency. See P. Beňo, *Mobbing je když...*, "Moderní vyučování" 2002, roč. 8, č. 3, p. 4–5.

[4] J. Chromý, *Násilí na pracovišti. Charakteristika, rizikové faktory, specifické formy a právní souvislosti*, Praha 2014, p. 190.

[5] H. Ege, *La valutazione per itale del danno da mobbing*, Milan 2002, p. 21–23.



of the employment relationship against the employee. It is necessary to highlight one of the most important principles of the labour law which is legal protection of the employee enacted in sec. 1a (1)a of the Act № 262/2006 Coll., the Labour Code (hereinafter referred as "LC")) as well as the principle of equal treatment of employees in sec. 1a (1)e LC. For this analysis also the principle of the whole private law[6] prohibiting the abuse of rights is important as well (see sec. 8 of the Act n. 89/2012 Coll, Civil Code (hereinafter "CC")).

The greater danger of this type of bullying, compared to mobbing, lies in the broader range of means that can be used by the employer to bully the employee. Bullying can then consist in assigning meaningless, unachievable tasks or vice versa tasks completely unnecessary and unrelated to the job description of the victim. It may also affect the amount of the employee's wage, especially if it is a discretionary salary component. Another example can be a repeated refusal of the employer to allow the employee to take a leave in the employee's chosen date. It can also consist of the total isolation of the victim or of the victim's permanent control and the necessity of the victim to consult every decision with a supervisor or one of his colleagues[7].

This paper deals with the problematic of the monitoring of employees and the obligation of the employer to protect the property of the employee on the one hand and the right of the employer to protect his property on the other hand. On the decisions of Czech Courts, the proportionality between these two principles will be demonstrated below.

## The employer's obligation to protect the employee's privacy

One of the key obligations of the employer, the violation of which can relatively easily become bossing, is the duty of the employer to protect the employee's privacy. This obligation is limited by the right of the employer to protect his property interests. Conflict of these two principles can cause interpretation problems in practise while the high preference of the property interests of the employer consist-

[6] To the applicability of the Civil Code also in the field of labor relations see sec. 4 LC or the decision of the Czech Constitutional Court from 12th March 2008 (Pl. ÚS 83/06).

[7] B. Huberová, *Psychický teror na pracovišti: mobbing*, Martin 1995, p. 101.

ing of excessive monitoring of employees could evidently include the signs of bullying.

The issue does not only enact the Labor Code in its sec. 316, but at this point we can again speak also about the collision of two constitutional principles, namely the employee's right to privacy at workplace as one of the aspects of the right to privacy under sec. 7 (1) of the Charter of Fundamental Rights and Freedoms (hereinafter "CHFRF") and the employer's rights to protect his own or entrusted property according to sec. 11 CHFRF[8].

The provision of 316 LC in its second paragraph provides that an employer may not, without good reason consisting in the special character of the employer's activities, disturb the privacy of employees at workplace and public areas of the employer by subjecting the employee to open or covert surveillance, interception and recording of his telephone calls, checking e-mails or correspondence addressed to employees. However, in the situations where the reason consisting in the special character is given, the sec. 316 (3) LC enacts the obligation of the employer to inform the employee about the extension of this control mechanism.

## Admissibility of monitoring of employees in case law

It is clear, that the legislation outlined above is very ambiguous, mainly due to the large number of vague legal terms which it contains. As described below, even the existing case law is not very helpful in this regard, since it affects only the sec. 316 (1) LC.

The first problem with the interpretation causes the term "special character of the employer's activities". It is obvious that banking activities or activities involving the processing of precious metals can be considered these activities. Special character of the employer's activities could be justified by the existence of business secret or trade secret. If harm threatened to the employer, then he would be entitled to provide the control of his property, but always in a reasonable way. The employee must be always informed about this control[9]. Regarding the criterion of adequacy, it is necessary to outline that the monitoring systems must interfere in the privacy of employees by the least burdensome manner. In the situation when the image capture is sufficient, the audio recording of employees must be considered as inadequate[10].

[8] M. Štefko in: M. Bělina a kol., *Zákoník práce. Komentář*, Praha 2015, p. 1241–1242 (sec. 316 LC).



The first paragraph of sec. 316 LC provides that employees may not use the employer's production and labour equipment, including computers and telecommunication equipment, for their personal use without the consent of the employer. The second sentence thereafter says that the employer is entitled to control adequately the compliance of this prohibition by employees.

The content of this provision will be described on the background of two decisions of the Czech Supreme Court, which provide a legal framework for its interpretation. The Supreme Court[11] had upheld the validity of immediate termination of employment of an employee who spent 102,97 hours/month of working time by ineffective work on the computer. The employer revealed this by monitoring these movements on the internet and then terminated the employment according to sec. 55 (1) b) LC immediately because according to him the employee breached the obligation that arises from the statutory provisions and relates to his work performance in an especially gross manner. During the trial the employee argued that although he spent 102,97 hours by non-work activities, it had no impact on the fulfillment of his duties. He also argued that the employer secretly monitored his use of the internet, contrary to sec. 316 (3) LC, without informing him.

The Supreme court, however, clarified that sec. 316 (3) LC is not applicable to the situations like this one, because in this case the employer only controlled if the prohibition enacted in sec. 316 (1) LC was observed by the employee. The purpose of the control wasn't to detect the content of e-mails etc. of this employee and thus monitor the employee's privacy, but only the control of observation of the prohibition in sec. 316 (1) LC. The Supreme Court didn't consider

[9] J. Vidrna, Z. Koudelka, *Zaměstnanci v objektivu kamer. Právní aspekty monitoringu zaměstnanců*, Praha 2013, p. 26–27.

[10] K. Petržela, J. Tomšej, *Kamerové systémy na pracovišti: Co je nutné dodržet*, "Právní rádce" 2013, roč. 11, č. 1, p. 54.

[11] See the decision of the Czech Supreme Court n. 21 Cdo 1771/2011 from 16th August 2012.

this control as an abuse of the rights of the employer and so called bulling, but he found this control legal and the termination of the employment as valid.

The more recent decision of the Czech Supreme Court[12] dealt with a similar situation at workplace and thus the admissibility of a control of the employee within the meaning of sec. 316 (1) LC. Even in this case, the Supreme Court agreed with the employer and stated that he was entitled to control the use of the business phone of the employee to determine if the phone was not used by the employee for private calls. The control was accidental, it never controlled the content of calls and so the Supreme Court ruled that also this control was legal because it was under the regime of sec. 316 (1) LC.

## Conclusion

It can be summarized that the employer has an opportunity to control the activities of employees during working hours. Protecting the privacy of the employee may be thus limited in some way. To complete the analysis of this institute it is necessary to cite also the decision of the Czech Constitutional Court[13] according to which the right to the protection against unauthorized intrusion into the privacy at workplace must be always observed by the employer with regard to private and family spheres of employees. But the employee is not in the above mentioned spheres when he is performing his labour obligations. In any case, it is necessary to use the proportionality test in the field of Labour Law. Only a reasonable employee's control may be considered lawful. Misuse of the employer's rights to protect his own property would result in workplace bullying, so called bossing. Employees can't be monitored and evaluated by the employer according to recording (e.g. as regards the behavior of employees to customers). Furthermore, if, on the basis of the recording the employment with the employee for breach of work duties has been terminated, it

[12] See the decision of the Czech Supreme Court n. 21 Cdo 747/2013 from 7th August 2014.

[13] See the decision of the Czech Constitutional Court n. I ÚS 452/09 from 31st March 2009.



is necessary to consider such evidence inadmissible, since the purpose of such recording is to protect property, not track the employee for the purpose of obtaining information for possible termination of employment.

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# DEVELOPMENT OF COMMON PROPERTY IN THE CZECH REPUBLIC

The consequence of marriage between man and woman is the emergence of life communion of the spouses which has essentially two aspects, personal and financial side. The historical development of these two parties of communion of the spouses evolved separately. Personal relations between spouses were the subject of canon law. Property relations of spouses were largely customary nature and the legislation was to the early 19th century fragmented[1].

## Episode from the year 1811

To change of the legal situation in (now) the Czech Republic occurred in 1811, when it was adopted Common Civil Code. To the effectiveness of the Common Civil Code in the Czech Republic there was not any uniform rule of matrimonial property regimes in the truest sense. Adjusting marital property rights was closely connected with the adjustment heritage. The primary purpose of marital property rights could therefore not ensure the spouses during the marriage, but to ensure the spouses in the event of dissolution of marriage because of the death of a spouse. The basic institute of marital property rights was the dowry, and some from the 13th century in the

[1] F. Rouček, J. Sedláček, *Komentář k československému obecnému zákoníku občanskému a občanské právo platné na Slovensku a v Podkarpatské Rusi. Díl pátý (§§ 1090 až 1341)*, Praha 1998, p. 1011; P. Konečná, *Manželské majetkové režimy*, [in:] *Encyklopedie českých právních dějin*, Plzeň 2016, p. 66–72.



Czech and Moravian Provincial law also called "rodinný nedíl" (Slavic also called "zádruha")[2].

Common Civil Code represented a major breakthrough in the legal regulation of marital property rights on Czech territory on which applied – at least in terms of legislation of marital property rights – until 1949 inclusive, because the independent Czechoslovak Republic General Civil Code took over to ensure continuity civil rights on Czech territory. On Slovak territory and Ruthenia remained in force Hungarian law[3].

The basis of property rights of spouses in the General Civil Code was dispositive regime of separate property in conjunction with the principle of freedom of contract. Thus, ownership status of spouses after marriage remained the same. Even after entering marriage spouses continue to observe its former ownership of property owned before marriage. None of the spouses to accrue on what the other spouse acquired. Each spouse may be freely dispose of their property and accounted only for its obligations. After the divorce between spouses usually occurred a specific property settlement. That was the last time on Czech territory until the adoption of the so-called new Civil Code in 2012 in the form of Law № 89/2012 Coll., Civil Code, which came into force on 1 January 2014, there was a regime of separate property. The new Civil Code of 2012 provides for a system of separate assets in § 729th. Unlike the Austrian rules contained in the General Civil Code, the current treatment regime of separate assets is an exception to the statutory property regime, not vice versa. Common Civil Code in fact allows the creation of community property of spouses through marriage contracts. Common Civil Code for the marriage contract did not specify a particular form, but later was legalized the form of a notarial deed. This form was customary for modifying lists to adoption of the new Civil Code, which instead of a notarial deed speaks of a broader concept, ie. a public document. Austrian legislation did not have any register of marriage contracts in contrast to the

[2] M. Laclavíková, *Formovanie úpravy majetkových vzťahov medzi manželmi: (od vzniku uhorského štátu do prvej československej kodifikácie rodinného práva)*, Bratislava 2010, p. 321; J. Dvořák, *Majetkové společenství manželů*, Praha 2004, p. 276; P. Konečná, *Manželské majetkové režimy*, [in:] *Encyklopedie českých právních dějin*, Plzeň 2016, p. 66–72.

[3] P. Konečná, *Manželské majetkové režimy*, [in:] *Encyklopedie českých právních dějin*, Plzeň 2016, p. 66–72.

current Czech legislation, which more cares about protection of third parties, for that reason there is inter alia a public list in which it's possible to optionally enroll modification agreement of the matrimonial property regime and obligatory judicial decisions which modify the common property. Common Civil Code, unlike existing legislation, defined the possibility of modifying the legal regime of property of spouses in dispositive way[4].

The conclusion of the wedding contract could occur both before entering into marriage and in its course, unlike the Act № 265/1949 Coll., on family law, effective from 1 January 1950 to 31 March 1964, which allowed to modify the statutory property regime only for the duration of the marriage. Community property of spouses was closing for the duration of the marriage and was cancellable. In comparison with the current legislation included in the new Civil Code none of the previous legislation until 31 December 1991 did not recognize the possibility to modify the matrimonial property regime by a court decision[5].

## Episode from the year 1950 to 1964

As already mentioned above, the legislation contained in the General Civil Code on the territory of the present Czech Republic, at least in relation to the legislation marital property rights, was effective until the end of 1949, when it was replaced by legislation contained in Act № 265/1949 Coll. on family law, effective from 1 January 1950 to 31 March 1964. In this act contained legislation marital property rights is radically different from the previous Austrian legislation, since it was based on the Soviet concept of family law and basically just copied the former Polish Family Code, or that reason it is therefore not necessary to further analyze. It is necessary to focus only on those aspects that were subsequently retaken in the following and existing legislation of matrimonial law. First, it should be

[4] Ibidem; F. Rouček, J. Sedláček, *Komentář k československému obecnému zákoníku občanskému a občanské právo platné na Slovensku a v Podkarpatské Rusi. Díl pátý (§§ 1090 až 1341)*, Praha 1998, p. 1011.

[5] P. Konečná, *Manželské majetkové režimy*, [in:] *Encyklopedie českých právních dějin*, Plzeň 2016, p. 66–72.



noted that "The Law on the right of the family" removed inequalities between men and women not only in the area of marital property rights. The code did not know the regime of separate estates, as the main legal form considered common property of spouses, which have the character of marital undivided property.[6]

Common property was formed of fortune that either spouse acquired during the period of marriage, except what has been acquired by inheritance or gift, and what served to the personal needs or professional needs to the one of the spouses. When enforcement proceedings were conducted only for the debt of a spouse, it was possible executory affect not only the assets of the debtor spouse, but also the assets of the joint property of both spouses, regardless of whether it was incurred before the conclusion of the marriage or in the course of marriage. This is the big difference compared to the current Czech legislation. When enforcement proceedings is conducted for a debt of only one spouse is punishable joint assets when the debt was incurred during the existence of the common property, unless the debt was incurred against the wishes of the other spouse, who its disagreement manifested without undue delay after he/she for the first time learned about the debt. However, if it is a debt for maintenance or debt from the unlawful act, it is possible to affect the common property only to the extent of which would have owed her husband felt if there was a settlement of marital property, as well as if the debt was incurred before marriage.

## The episode from the year 1964 to 2013

This episode is characterized by the fact that it was (at least in most of its parts) completely beyond the prior and subsequent evolution of marital property rights. The basic legislation of marital property rights was in law № 40/1964 Coll., Civil Code, which was effective from 1 April 1964 to the end of the year 2013. As a fundamental institution it considered marital property rights undivided co-ownership, which included just things, not the obligations and rights. That it changed in

[6] R. Veselá a kol., *Rodina a rodinné právo – Historie, současnost a perspektivy*, Praha 2005, p. 88.

1998, when undivided co-ownership of common assets of spouses was replaced by common (joint) property of spouses, which since than it has been the legal property regime to the present. Although the legislation on Czech territory existed for quite a long time, it is not necessary to extensively deal with this episode because it differs significantly from modern concepts of marital property right.

## The episode from the year 2014

The new Civil Code which became effective January 1, 2014, builds on existing legislation. The basic institute of marital property law under this code is common property which with effect from 1 August 1998 replaced the undivided co-ownership of spouses. It includes everything that belongs to the couple, has an asset value and is not ruled out legal circumstances, unless the joint property is not obscured during the marriage under the law. Unlike undivided marital property, whose legislation between 1964 and 1991 admitted only basic legal regime of marital property without any contractual modification, existing legislation of marital property rights respects fairly wide contractual autonomy, so that means it shall be subject to statutory or agreed-upon mode or regime based court decision[7].

A mainstay of the legislation marital property rights is (obviously) a statutory regime, which automatically applies only if the spouses contractually agreed otherwise or if it is not stated otherwise by court decision. The statutory scheme therefore determines what and under what circumstances is included in common property, respectively it is excluded in the individual property of one spouse, and how this is managed.[8]

Conventional mode is a law certificated possibility to derogate under specified statutory preconditions from either mode, before concluding the marriage in the event of closure, or the date of its establishment throughout its existence but never retroactively. It reflects the

[7] P. Konečná, Smluvený režím společného jmění manželů ve světle novely občanského zákoníku, [in:] J. Hurdík, P. Lavický, J. Valdhans, *DNY PRÁVA 2014 – Část I. – Soukromé právo a civilní proces v dynamice vývoje*, Brno 2015, p. 210–223.

[8] P. Konečná, *Autonomie vůle v manželském majetkovém právu*, [in:] L. Piechowiczová, L. Madleňáková, *Autonomie vůle*, Praha 2014, p. 47–53.



principle of (limited) party autonomy in conjunction with the principle of freedom of contract. Limited because fiancés and spouses can negotiate just one of the law predicted agreed modes, which are – the regime of separate assets, reserving the creation of joint property upon termination of marriage, widening or narrowing of joint property. May do so only in the form of a public document – as was said before. Conventional mode may relate to the entire joint property or just only a part thereof, or specific things, incl. parts and things just acquired in future. With the exception of cases where one spouse has permanently left the household and refuses to return to it, you cannot exclude or modify the scope/content of the common (usual) household. It consists of a set of movables, which are used commonly necessary environmental needs of the family and its members, regardless of whether the individual case belongs to both spouses and only one of them[9].

[9] Ibidem, p. 47–53.

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# THE INCREASING ROLE OF THE EU PRINCIPLE OF ANTI-DISCRIMINATION IN ITALIAN LABOUR LAW: THE CASE OF DISMISSAL

## The EU concept of anti-discrimination and its impact on Italian law

In recent years one of the most relevant trends with respect to the "evolution of private law" (focusing on Italian labour law) concerns the increasing role of the EU principle of anti-discrimination, *i.e.* the principle according to which no one can be treated – also through a neutral provision – less favorably than anybody else who is or has been or would be treated in a comparable situation based on certain grounds[1], unless the treatment is objectively justified by a legitimate aim and the means of achieving that aim are appropriate and necessary.

[1] It seems incontrovertible that the discriminatory grounds can't be considered as an open list (cf.: The European Commission, *The Prohibition of Discrimination under European Human Rights Law. Relevance for the EU non-discrimination directives – an update, Office for Official Publications of the European Communities*, Luxemburg 2011, freely available online: http://ec.europa.eu, which says «the... choice made by the EU Member States when they adopted the Treaty of Amsterdam [was] to provide the Council with the power to adopt measures against discrimination based on a limited number of grounds – race or ethnic origin, sex, sexual orientation, religion or belief, disability and age»; see also: CGUE 7 July 2011; C-310/10 and CGUE 18 December 2014 C-354/13, all of them freely available online:www.curia.europa.eu.



Although it is well known that the concept of anti-discrimination – which is a corollary of the equality principle[2] – was imported[3] by the EU from International Law[4], nevertheless it is possible to address it as an EU principle because it has been greatly shaped and enlarged by EU law[5].

[2] The principle of equality appeared for the first time in the United States Declaration of Independence in 1776. In Europe it appeared twelve years later in the Declaration of Human and Civil Rights in 1789. Then it was used, after the Second World War, as a key principle by many European Constitutions (cf., for example, the art. 3 of the Italian Constitution enacted in 1948 which says: «All citizens have equal social dignity and are equal before the law, without distinction of sex, race, language, religion, political opinion, personal and social conditions. It is the duty of the Republic to remove those obstacles of an economic or social nature which constrain the freedom and equality of citizens, thereby impeding the full development of the human person and the effective participation of all workers in the political, economic and social organisation of the country»). See on the meaning of equality as a legal concept and its relationship to the principle of non-discrimination: E. Ellis, P. Watson, *EU Anti-discrimination Law*, Oxford University Press, Great Britain, II edition, 2012, p. 2 ss. and A. McCologan, *Discrimination, equality and the law*, Hart Publishing, Oxford, 2014.

[3] As well known, at the beginning the EEC established only two non-discrimination principles which were functional to the common market: the equal pay for equal work between men and women (art. 119 EEC) and the prohibition of discrimination on grounds of nationality (art. 48 EEC). Only in 1974 (when the First Programme of Social Action was signed) the Community started to develop the so called EU anti-discrimination law.

[4] Cf. C. Tobler, Indirect discrimination. A case study into the Development of the Legal Concept of Indirect Discrimination under EC Law, Antwerpen, Oxford, 2005, p. 89 ss., who remembers that the concepts of direct and indirect discrimination appeared for the first time in the art. 5 of the International Declaration of Human Rights developed in 1929 by the International Law Institute. About the difference between the principle of anti-discrimination within the EU and the one at the international level see Council of Europe, Hanbook on European non discrimination law, Publications office of the European Union, Luxemburg, 2011; B. Nicholas, *Prohibited Grounds of Discrimination under EU Law and the European Convention on Human Rights: Problems of Contrast and Overlap*, "Cambridge Yearbook of European Legal Studies" 2006–2007, Vol. 9, 1–42 and T. Koyama, M.K.G. Landaburu, F. Marinelli, A. Mattei, Q. Detienne, G.B. Yildiz, E. Zurauskaite, *Multilevel tools for protection of social rights: a hypothesis, in Ricerche giuridiche (Edizioni Ca' Foscari)*, vol. 4, № 1, p. 153 ss.

[5] Cf. S. Sciarra, *The evolution of Labour law – General Report, Luxembourg: Office for Official Publications of the European Communities*, 2005, p. 56 (Retrieved June 15, 2016 from: www.metiseurope.eu/content/pdf/n8/4_sciarra.pdf) who writes: «There is no doubt that anti-discrimination law represents the area in which the impact of EU law has been most remarkable, in terms of quality of the legislation and for its dissemination in all countries». For an overview of non-discrimination law within the EU see E. Ellis, P. Watson, *EU Anti-discrimination Law*, cit. For an overview of the EU anti-discrimination policy see T.E. Givens, R.E. Case, *Legislating Equality. The Politics of Anti-discrimination Policy in Europe*, Oxford University Press, United Kingdom 2014.

Even though Italy – like all the28 EU countries[6] – has transposed the EU anti-discrimination measures[7] during the years developing domestic provisions[8] which have affected, *inter alia*, also labour law, nevertheless the principle of anti-discrimination has played a marginal role until the recent years.

This is particularly true if we give a glance to the dismissal, *i.e.* the case of the termination of employment by an employer against the will of the employee.

## The Italian roots of discriminatory dismissal

The prohibition of dismissal for discriminatory reasons has been introduced in Italian labour law, for the first time, by the Law № 604 enacted in 1966. Its art. 4 – still in force – prohibits dismissal based on religious belief, political opinion, trade union membership or activities.

To cut a long story short, we can say that during the years the recalled provision has been not only confirmed, but also transformed by many other dispositions[9], most of them, as said, deriving from the EU law[10]. So that, nowadays, it sounds like: any dismissal which

[6] Cf. on this subject I. Chopin, C. Germaine-Sahl, *Developing anti-discrimination law in Europe: the 28 EU member states, Former Yugoslav Republic of Macedonia, Iceland, Liechtenstein, Norway and Turkey compared*, Publications Office of the European Union, Luxemburg 2013.

[7] See in particular: Directive 75/117/EEC; Directive 76/207/EEC; Directive 79/7/EEC (all of them repealed by the Directive 2006/54/EC); Directive 86/378/EEC (repealed by the Directive 54/2006/EC); Directive 86/613/EEC (repealed by the Directive 2010/41/EU); Directive 97/80/EC (repealed by the Directive 54/2006/EC); Directive 2000/43/EC; Directive 2000/78/EC; Directive 2004/113/EC; Directive 2006/54/EC; Directive 2010/41/EU.

[8] See, in particular: Law № 903/1977 (repealed by the Legislative Decree № 198/2006); Law № 108/1990; Law № 135/1990; Law № 125/1991 (repealed by the Legislative Decree № 198/2006); Law № 40/1998 (repealed by the Legislative Decree № 286/1998); Legislative Decree № 215/2003; Legislative Decree № 216/2003; Legislative Decree № 276/2003 (in particular art. 10); Legislative decree № 145/2005; Legislative decree № 67/2006; Legislative Decree № 198/2006; Legislative Decree № 196/2007; Legislative Decree № 5/2010; Legislative Decree № 150/2011 (in particular art. 28).

[9] To cite only the main dispositions still in force: art. 15 Law № 300/1970; art. 3 Law № 108/1990; Legislative Decree № 286/1998; Legislative Decree № 215/2003; Legislative Decree № 216/2003; Legislative Decree № 198/2006.

[10] Deriving, in particular, from three Directives: the Directive 2000/43/EC; the Directive 2000/78/EC and the Directive 2006/54/EC.



– regardless of the so-called *animus discriminandi* of the employer – has a bad effect on one or more persons for one or more of peremptory reasons[11] (sex[12], colour[13], race[14], national or ethnic origin[15], language[16], citizenship[17], handicap[18], religion[19], personal belief[20], trade union membership or activities[21], political opinion[22], sexual orientation[23], age[24], parenthood, pregnancy, or exercise of the rights resulting from these statuses[25], harassment and sexual harassment, reaction to a complaint within the undertaking or to any legal proceedings aimed at enforcing compliance with the principle of equal treatment between men and women[26]) is prohibited, unless the dismissal is objectively justified by a legitimate aim.

In case of discriminatory dismissal the sanction granted by the Italian legislator has always been the strongest, *i.e.* the reinstatement of the employee unfairly fired regardless of the employer's size[27]. It means that the empolyer must both reinstate the employee and pay him/her an indemnity equal to the salary due from the date of dismissal to the date of reinstatement[28].

[11] Except for some scholars (cf., for example, M.T. Carnici, *Il rapporto di lavoro al tempo della crisi: modelli europei e flexicurity 'all'italiana' a confronto, in Giornale di diritto del lavoro e delle relazioni industriali*, 2012, p. 527 ss.), it seems incontrovertible that also in the Italian legal system the discriminatory grounds can't be considered as an open list, as suggests both the literal interpretation of the Italian acts and their derivation from EU law.

[12] Cf. art. 15, Law № 300/1970; art. 25 Legislative Decree № 198/2006.

[13] Cf. art. 43, Legislative Decree № 286/1998.

[14] Cf. art. 15, Law № 300/1970; art. 43 Legislative Decree № 286/1998; art. 1 Legislative Decree № 215/2003.

[15] Cf. art. 43 Legislative Decree № 286/1998; art. 1 Legislative Decree № 215/2003.

[16] Cf. art. 15 Law № 300/1970; art. 43 Legislative Decree № 286/1998.

[17] Cf. art. 43 Legislative Decree № 286/1998.

[18] Cf. art. 15 Law № 300/1970; art. 1 Legislative Decree № 216/2003.

[19] Cf. art. 4 Law № 604/1966; art. 15 Law № 300/1970; art. 1 Legislative Decree № 216/2003.

[20] Cf. art. 1 Legislative Decree № 216/2003.

[21] Cf. art. 4 Law № 604/1966 and art. 15 Law № 300/1970.

[22] Cf. art. 4 Law № 604/1966; art. 15 Law № 300/1970.

[23] Cf. art. 15 Law № 300/1970; art. 1 Legislative Decree № 216/2003.

[24] Cf. art. 15 Law № 300/1970; art. 1 Legislative Decree № 216/2003.

[25] Cf. art. 25 Legislative Decree № 198/2006.

[26] Cf. art. 26 Legislative Decree № 198/2006.

[27] Cf. art. 3 Law № 108/1990.

[28] If the employee refuses reinstatement he/she must receive 15 months' salary plus the indemnity (cf. art. 18 Law № 300/1970).

## The marginal role played in the past by the discriminatory dismissal within Italian labour law

Even though the aforesaid prohibition to dismiss for discriminatory reasons has been developed greatly during the decades in accordance with the EU anti-discrimination law, it has played a significant role in the Italian legal system only starting from 2012 when the Italian legislator began the process of reforming the domestic labour law in order to adapt it to the challenges of the economic and debt crisis.

The reason for this marginal role played in the past by the discriminatory dismissal can be found in the law. In fact before the recent reforms the Italian law maker condemned the very same way (*i.e.* reinstatement) both the discriminatory dismissal[29], regardless of the employer's size, and the one without just cause or justified reason when imposed in the medium and large sized firms[30] (it means in the firms with more than 15 employees in each business unit – or more than 5 in the agricultural sector – or more than 60 employees at the national level regardless the business unit). This identity of the remedies in addition to the fact that in Italian labour law the burden of proving the just cause or the justified motive for the dismissal always lies with the employer[31], whereas the onus of proving the discriminatory dismissal lies with the employee only up to a point (*id est* only until he/she gets a *prima facie* case, then it shifts on the employer[32]) brought to the prevalence in practice of the former type of dismissal.

In fact it is clear that until the protection between the two types of dismissals was the same, it was more advantageous for the employees to claim for a dismissal without a just cause or a justified reason

[29] Cf. art. 3 Law № 108/1990.

[30] Cf. the art. 18 Law № 300/1970 before the Law № 92/2012.

[31] Cf. art. 5 Law № 604/1966.

[32] Cf. art. 28 Legislative Decree № 150/2011 and art. 40 Legislative Decree № 198/2006 which both follow the EU principle (cf. art. 10 Directive 2000/78/EC; art. 8 Directive 2000/43/EC and art. 19 Directive 2006/54/EC) under which: where in case of conflict the employee is able to establish facts from which it may be presumed that there has been discrimination on one of the prohibited grounds it shall be for the other party to prove that there has been no breach of the provisions prohibiting discrimination. This means that the facilitation of the burden of proof depends on the so called judicial discretion.



than for a discriminatory one because in the former case the burden of proof was less heavy in exchange of the same protection (*id est* the reinstatement).

## The increasing role played by the discriminatory dismissal in Italian labour law after the so called Monti/Fornero Reform (Law № 92/2012) and the Jobs Act (in particular, Legislative Decree № 23/2015)

As anticipated, the aforesaid marginal role played by the discriminatory dismissal has changed when, under the pressure of the EU[33], the Italian lawmaker started the process of reforming the domestic labour market.

The first act enacted was the Law № 92/2012, known as "Monti/Fornero Reform" reform which has provided for, *inter alia*, a reduction of the reinstatement remedy, establishing the reinstatement protection mainly[34] for discriminatory dismissals, while for the ones without just cause or justified reason the main[35] rule has become the compensatory protection[36].

[33] Cf.: the confidential letter sent in August 2011 by the European Central Bank to the Italian Govern, asking a review of rules regulating dismissal of employees in order to enhance flexibility within the Italian job market and so restore the confidence of investors after the global economic downturn; The Euro-Plus Pact adopted in March 2011 under EU's Open Method of Coordination, as an intergovernmental agreement between all Member States of the EU (except Croatia, Czech Republic, Hungary, Sweden and UK), in which concrete commitments were made to be working continuously within a new commonly agreed political general framework for the implementation of structural reforms intended to improve competitiveness, employment, financial stability and the fiscal strength of each country; the Recommendation of 12 July 2011 on the National Reform Programme 2011 of Italy and delivering a Council opinion on the updated Stability Programme of Italy, 2011–2014 where the EU recommended the Italian Government to take action within the period 2011–2012 to reinforce measures to combat segmentation in the labour market, also by reviewing selected aspects of employment protection legislation including the dismissal rules.

[34] In fact in the Law № 92/2012 the reinstatement protection appeals in all the cases of nullity of the dismissal (see art 1 paragraph 47 Law № 92/2012).

[35] In fact, in the Law № 92/2012 there are still a few cases of dismissal without a just cause or a justified reason covered by the reinstatement (see art 1 paragraph 47 Law № 92/2012).

[36] The compensation shall be between a minimum of 6 and a maximum of 24 monthly salaries depending on the specific situation and taking into consideration: employment

Three years later the Legislative Decree № 23/2015[37] – enacted to decrease the firing costs as regards any employee hired after its entering into force[38] – has followed the same rule: the reinstatement remedy mainly[39] for discriminatory dismissals and the compensatory protection (lower than the one accorded by the Law № 92/2012[40]) mainly[41] for the ones without just cause or justified reason.

Obviously, this new rule contained both in the Law № 92/2012 and in the Law № 23/2015 has completely modified the balance between the dismissal without a just cause or a justified reason and the discriminatory one – as demonstrated by the circumstance that the number of lawsuits complaining the discriminatory dismissal is definitely increased in comparison with the past[42]. In fact nowadays the employees, in order to obtain the strongest protection (*id est* the reinstatement), shall demonstrate that the dismissal was based on discriminatory grounds. Thus the remedy in case of proving the dismissal without a just cause or a justified reason is only a compensatory one.

soundness and size of the undertaking, the employee's seniority, behavior of the parties (art. 1 paragraph 47 Law № 92/2012).

[37] This is one of the acts enacted to put in place the last labour market reform called "Jobs Act". It should be stressed that "Jobs Act" (which recall the American "Jumpstart Our Business Startups Act") is the expression used by the Italian legislator to refer not to a precise act but to a significant labour market reform implemented by several Legislative Decrees and based upon the guidelines provided by Law № 183/2014.

[38] Law № 23/2015 entered into force on the 7 March 2015.

[39] In fact in the Law № 23/2015 the reinstatement protection appeals in all the cases of nullity of the dismissal (see art. 2 Law № 23/2015).

[40] Legislative Decree № 23/2015 has established new criteria to fix the amount of the compensation, which make the calculation rigid and automatic, thus evading the judicial discretionary power. In fact the compensation may no longer be weighed carefully by taking the specific situation into consideration: employment soundness and size of the undertaking, the employee's seniority, behavior of the parties, but also drastically reduce the figure. In the event of unjustified dismissal by medium and large sized employers, the compensation will be equal to 2 monthly salaries for each year of seniority of the employee, between a minimum of 4 and a maximum of 24 monthly salaries (art. 3 Legislative Decree № 23/2015). It shall then be reduced to half in the event of flawed grounds or procedure. Those moderate amounts are then bound to go down further if the parties agree to the conciliation under the Legislative Decree (art. 9 Legislative Decree № 23/2015). This possibility is widely boosted due to the fact that, in this case, the disbursements made to the employee are not taxable income (art. 6 Legislative Decree № 23/2015). Cf. M. T. Carinci, "In the spirit of flexibility". An overview of Renzi's Reforms (the so-called Jobs Act) to "improve" the Italian Labour Market, in Working Papers CSDLE Massimo D'Antona – IT, № 285/2015, freely available online: http://csdle.lex.unict.it. [Retrieved June 15, 2016]).

[41] In fact in the Law № 23/2015 there are still a few particular cases of dismissal without a just cause or a justified reason covered by the reinstatement (see art. 3 Law № 23/2015).

[42] Cf. C. Giorgiantonio, *Riforma del mercato del lavoro e giudizi sui licenziamenti individuali: prime evidenze, in Working Papers CSDLE Massimo D'Antona – IT.*, № 210/2014, p. 12, freely available online: http://csdle.lex.unict.it [Retrieved June 15, 2016].



## Conclusion

The above analysis shows how the narrowing of the scope of reinstatement, realized by the Italian legislator in 2012 and in 2015 in accordance with the EU guidelines, has significantly granted more power to the employers. In fact nowadays the employee may be lawfully dismissed also proving that the dismissal was not supported by a just cause or a justified reason. In case of dismissal in breach of the principle of justification the employer would be only condemned to pay an indemnity. In fact, the only way the employee can maintain his/her job is proving that the dismissal was based on discriminatory grounds[43].

Thus, the discriminatory dismissal, although implies a heavier burden of proof than the one without a just cause or a justified reason, is going to lose the marginal role which has played in the past and become the most important figure in the discipline concerning the unfair dismissal.

Although it is not possible here to go into more detail, it is quite simple to see that following this peculiar trend the Italian lawmaker, supported by the EU, has put for the first time the principle of anti-discrimination at the centre of the legal system as the American one has always done. In fact, as well known, American anti-discrimination law gives to the worker the strongest protection, *inter alia*, also against the dismissal[44]. What is surprising about this trend is

[43] As someone said «in solving the conflict between the employer's interest... in arranging the organization... and the... employee's interest in keeping his/her own job... [the new reforms] significantly shift... the point of balance in favour of the former» (M.T. Carinci, *"In the spirit of flexibility". An overview of Renzi's Réforms (the so-called Jobs Act) to "improve" the Italian Labour Market*, cit.).

[44] See M.A. Rothstein, L. Liebman, *Employment Law. Cases and Materials*, Foundation Press, New York 2011, p. 838 ss. and A.L. Goldman, R.L. Corrada, *Labour Law in the USA*, Wolters Kluwer Law & Business, The Netherlands 2014, p. 98 who reminds that: «since the late 19th century, American courts have treated employment as a contractual relation-

that the Italian Law system is copying the American one with reference to the dismissal which has always been «at the heart of labour law ... in all EU Member States»[45] because of the fact that it implies for the workers «not only loss of income but in our culture ... loss of ... identity as well»[46].

To conclude, in a *de iure condendo* perspective,the question we should ask ourselves is whether the American anti-discrimination law can offer tools that the Italian lawmaker should import in order to increase the (still low[47]) effectiveness of the Italian anti-discrimination law.

ship that either side has the power to terminate without explanation or justification unless the parties have placed specific restrictions on that power». Most of the States in the United States are "at-will" employment States, it means that if a person is an "at-will" employee they can be fired unexpectedly, with no notice and for any reason.

[45] A. Jacobs, *Labour and the Law in Europe. A Satellite View on Labour Law and Social Security Law in Europe*, Wolf Legal Publishers, The Netherlands 2011, p. 69.

[46] Cf. M.A. Rothstein, L. Liebman, *Employment Law. Cases and Materials*, cit., p. 838.

[47] The Italian scholars agree on the low effectiveness of the Italian anti-discrimination law.

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# DEVELOPMENT OF MEDIATION IN THE ENTERTAINMENT INDUSTRY IN UKRAINE: SOME NEW CHALLENGES

The entertainment industry in Ukraine is a growing market entailing big investments, great number of consumers and huge income for its successful players. Development of this industry causes arising of new types of legal relations, the breach of which entails arising of new types of conflicts. Such situation calls for creation of new mechanisms being able to resolve these disputes effectively. One of such mechanisms appears to be mediation as an alternative method of dispute resolution.

Mediation is a special type of dispute resolution where a neutral intermediary helps the parties to reach a mutually satisfactory settlement of their conflict[1]. The mediation shall be distinguished from the arbitration or court proceedings where the arbitrator or the judge can issue a decision that is compulsory for all the parties to the dispute. Mediation is voluntary, provides the parties with the possibility to choose a mediator by themselves, is flexible, mobile and confidential and allows to save good relations with the adverse party.

The Constitution of Ukraine serves as a legal basis for mediation in Ukraine, stipulating that anyone is entitled to protect his/her rights and freedoms from violation and illegal encroachment by any means that are not prohibited by law (Part 4 of Article 55)[2]. While special laws on mediation are adopted in many countries of the world there is no such law in Ukraine. The importance of adoption of such law

[1] What is Mediation? Retrieved June 15, 2016 from: http://www.wipo.int/amc/en/mediation/what-mediation.html.

[2] Konstytutsiya Ukrayiny, Vidomosti Verkhovnoyi Rady, 1996, № 30.

can be emphasized by a number of draft laws on mediation that were registered in the Supreme Council of Ukraine (1 draft registered in 2010, 1 – in 2011, 3 – in 2012, 2 – in 2013, 1 – in 2014 and 4 – in 2015).

Analysis of jurisprudence allows to conclude on existence and successful development of the following spheres of mediation: commercial, labour, civil, family, school, religious, healthcare, environmental ones etc. Taking into account the peculiarities of the entertainment sphere, it is necessary to mediate the disputes arising in this industry as well, bearing in mind the following considerations:

- first of all, the resolution of disputes arising in the entertainment industry requires specific knowledge (for example – deciding on whether the work is creative or not), especially knowledge of how this business works;
- such disputes require very fast resolution, that is caused by changeability of show business. Sometimes the work on the project can be planned to last several months, weeks or even days. In order to complete the project on time it is necessary to solve all the project-related problems very fast;
- the players of the entertainment market need to ensure the confidentiality of disputes` resolution. As T. Ostrander notes, confidentiality of the dispute can either save the reputation of the performer of help to keep in secret the plot of airing TV series[3];
- the entertainment market includes a limited number of players, for example there is a certain number of production centers in Ukraine and one performer may be forced to work with the same production center for a long period of time. In such situation both parties are interested into keeping good relations between them.

One of the recent examples of mediation in the entertainment industry is resolving the conflict between the director of "The Hobbit" Peter Jackson and the Actors` Unions in New Zealand. Prime Minister of New Zealand, John Key, has offered government mediation for the parties because he was concerned that New Zealand could lose the project, resulting in losses for tourism industry in the country[4].

[3] T. Ostrander, *A Comparative analysis of the uses of mediation in the entertainment industry*, Cornell HR Review, p. 2–3. Retrieved June 15, 2016 from: http://digitalcommons.ilr.cornell.edu/chrr/50.

[4] New Zealand PM offers mediation over Hobbit. Retrieved June 15, 2016 from: http://www.cbc.ca/news/arts/new-zealand-pm-offers-mediation-over-hobbit-1.916202.



An investigation of Ukrainian mediation market reveals such centers of mediation as Ukrainian Mediation Center, that is functioning in Kyiv-Mohyla Business School[5], Center of Mediation at the Kyiv Chamber of Commerce and Industry[6] etc. Some law firms offer the services of mediation in the sphere of intellectual property. Nevertheless one can not find any mediation center that offers the services in the sphere of entertainment.

In the meantime there is a number of **mediation centers resolving conflicts in the sphere of entertainment** that function in the world. For example:

- *The JAMS Entertainment and Sports Group* that offers the mediation services involving disputes in the film industry, first amendment rights (defamation, privacy), conflicts entailing the activity of different guilds, multimedia disputes, conflicts in the music industry, publishing and printed media, sports, theater, TV and radio, visual arts and design[7];
- *CEDR Solve* offering the services of settling the disputes relating to "production, development, licensing and distribution rights, financing and sponsorship, brand protection, image rights, talent management (including sports disciplinary) and tourism-related group actions"[8];
- *Entertainment Mediation Institute*, the mediators of which are qualified to mediate the conflicts of "Studios, Independent Production & Distribution Companies, Television Networks & Cable Companies, Industry Guilds & Unions, Talent Agencies, Management Companies, Industry Talent, including Screenwriters, Authors, Producers, Directors, Directors of Photography, Editors, Composers, Musicians, Performers, as well as Film Commissions, Foreign Cultural, Film & other Governmental Departments, Banks & other produc-

[5] Mission and tasks of the Center. Retrieved June 15, 2016 from: http://ukrmediation.com.ua/en/about_center/mission_and_objectives/.

[6] Kyiv Chamber of Commerce and Industry. Retrieved June 15, 2016 from: http://kiev-chamber.org.ua/en.

[7] Practice: Entertainment and Sports. Retrieved June 15, 2016 from: http://www.jamsadr.com/entertainment/.

[8] Media, Entertainment and Sport. Retrieved June 15, 2016 from: http://www.cedr.com/solve/media.

tion financiers, Insurance providers, Theater Owners and other related Entertainment Industry entities"[9];

- As T. Ostander notes, there are a lot of *organizations in the USA staffed by lawyers acting on behalf of the art groups and performers* in different areas of entertainment industry pro bono, including offering the mediation services to these parties. Such organizations can be found not only in New York and California, but also in Florida, North Carolina, Ohio and Pennsylvania. There is a special Arts Arbitration and Mediation Service started in 1980 by the California Lawyers for the Arts[10];
- The mentioned types of disputes can also be submitted for consideration to *WIPO Arbitration and Mediation Center*. WIPO Mediation Rules, effective from January 1, 2016 (hereinafter – WIPO Mediation Rules) contain several provisions that allow to settle the dispute in the sphere of entertainment efficiently: the possibility to agree on the person of the mediator or on specific procedure for appointing the mediator (Article 7); the possibility to agree on conduction of the mediation by the parties themselves (Article 10); confidentiality provisions (Articles 15 – 18); the rules on waiver of defamation, in accordance with which any statements made by the parties in course of the mediation shall not be relied upon to cause or maintain any action for defamation or any other related complaint (Article 27)[11].

Taking into account the absence of the specialized center of mediation considering the disputes in the sphere of show business and the necessity to settle these disputes on a time effective and confidential basis the existence of such center in Ukraine is crucial. In our opinion the rules of the newly created center shall be formed on the basis of WIPO Mediation Rules.

The current Ukrainian legislation does not contain any requirements for the **mediators** in general and for the mediators in the entertainment industry in particular. One can not argue that the mediator should have relevant competence in the sphere of mediation. Such requirement is set by the European Code of Conduct for Mediators. Pursuant to Article 1.1 of this Code "mediators must be competent and knowledgeable in the process of mediation. Relevant factors include proper training and continuous updating of their education and practice in mediation skills, having regard to any relevant standards or accreditation schemes"[12].

The most recent Draft Laws of Ukraine contain the requirements for mediators. For example in accordance with Art. 16 of Draft Law "On Mediation" dated December 17, 2015, № 3665 (hereinafter – Draft Law № 3665) natural person that reached the age of 25, has higher or professional technical education and has completed professional training that should comprise 90 academic hours of preliminary studies, including 45 academic hours of practical training, can become a mediator. Persons with partial or full incapacity; persons with outstanding convictions; judges, prosecutors, investigators, state officials, officials of the bodies of self-government that were fired for violation of oath or for corruption; state officials; persons that were excluded from the register of mediators as a result of violation can not become mediators[13]. Article 5 of Draft Law "On Mediation" № 3665-1 dated December 29, 2015 (hereinafter – Draft Law № 3665-1) states that a natural person that has reached the age of 21 and has completed professional studies under the specialization "Mediation" in Ukrainian educational institution or the one outside Ukraine can become a mediator. A person with partial or full incapacity can not become a mediator. Professional preparation of mediators shall include not less than 120 academic hours of theoretical and practical studies, with not less than 60 academic hours of practical trainings[14].

The question on the specialization of higher education of the mediator is the subject of long discussion. One authors think that only lawyers shall be allowed to mediate while the others consider that

[9] The Entertainment Mediation Institute. Retrieved June 15, 2016 from: http://entertainmentmediationinstitute.com/.

[10] T. Ostrander, *A Comparative analysis of the uses of mediation in the entertainment industry*, Cornell HR Review, p. 3. Retrieved June 15, 2016 from: http://digitalcommons.ilr.cornell.edu/chrr/50.

[11] WIPO Mediation Rules, effective from January 1, 2016. Retrieved June 15, 2016 from: http://www.wipo.int/amc/en/mediation/rules/#2.

[12] European Code of Conduct for Mediators. Retrieved June 15, 2016 from: http://ec.europa.eu/civiljustice/adr/adr_ec_code_conduct_en.pdf.

[13] Proekt Zakonu Ukrayiny Pro Mediatsiyu, December 17, 2015, № 3665. Retrieved June 15, 2016 from: http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=57463.

[14] Proekt Zakonu Ukrayiny Pro Mediatsiyu, dated December 29, 2015, № 3665-1. Retrieved June 15, 2016 from: http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=57620.

professional psychologist or physician can provide the parties with better assistance in some types of cases[15]. Nevertheless, more scholars believe that the mediator shall hold a degree in law. The role of the attorney at law in mediation proceedings is a popular direction of legal research in Ukrainian civil law doctrine.

Taking into account the absence of imperative requirements in Ukrainian legislation, any natural person with full legal capacity can become a mediator. In our opinion it is better to choose mediators among entertainment lawyers or producers or other specialists in the entertainment sphere in order to settle the cases in a most efficient way. As far as we can see, in order to make the institution of mediation alive in Ukraine it is necessary to adopt the law with the following requirements for mediator: he/she should hold a degree in law and complete a special course of preparation for mediators.

A necessary pre-condition of mediation is the conclusion of **mediation agreement**. The current Ukrainian legislation provides neither for the definition of such agreement nor for its requirements. Pursuant to Article 10 of Draft Law № 3665 the parties are entitled to agree on entering a written mediation clause into the agreement in accordance with which they agree to submit for mediation all or some disputes that can arise between them in any concrete legal relations, irrespectively of whether such relations arise from contract or not. The mediation clause does not preclude the parties from addressing to the court or arbitration. In accordance with Art. 18 of Draft Law № 3665-1 the mediation agreement shall be concluded in written form between the mediator and the parties to the dispute. The mediation agreement shall include the following conditions: mediator; parties to the conflict; order, scope and form of paying of mediation fees and reimbursing the expenses on preparation and conduction of mediation; mediation language and agreement reached by the parties; necessity to hire the translator or other persons (optional); terms and place of conduction of mediation; other conditions agreed by the parties.

Bearing in mind the peculiarity of the entertainment sphere, one should note that the disputes involving the players of the mentioned industry can arise out of contracts, our of torts or out of the other

[15] Y. Kolyasnikova, *Primiritelnyye protsedury v arbitrazhnom processe: dissertatsyya*, Ekaternburg 2009, p. 136.



grounds. It can happen that the parties wish to mediate their dispute despite the absence of written mediation agreement entered into by them. Article 4 of WIPO Mediation Rules enables the parties to conduct the mediation in the absence of a mediation agreement, allowing the party that wishes to propose submitting a dispute to mediation to submit a Request for Mediation in writing to the WIPO Arbitration and Mediation Center. It shall at the same time send a copy of the Request for Mediation to the other party. The Request for Mediation shall include the particulars set by the WIPO Mediation Rules. The WIPO Arbitration and Mediation Center may assist the parties in considering the Request for Mediation. In our opinion, these flexible rules can broaden the scope of disputes to be mediated and shall be included into the current Ukrainian legislation.

Successful mediation shall be terminated by conclusion of **settlement agreement** by the parties that is binding for them. The experts of Ukrainian Mediation Center outline the following ways to complete the mediation process that are possible under Ukrainian legislation:

- settlement of the dispute orally that is not typical for business disputes and is applicable for family conflicts and some other non-business disputes;
- entering into a settlement agreement that can be notarized;
- entering into a named civil agreement (gift agreement, novation agreement etc.). Given that the settlement agreement is not regulated by any specific rules of the current Ukrainian civil legislation it is advisable to conclude a named civil agreement if the relations between the parties allow entering into such an agreement;
- entering into an amicable agreement in case if the dispute of the parties has already been submitted for consideration to the court. The only restriction is that the agreements of the parties can not fall outside the scope of the claim demands[16].

One of new trends in the world **is online dispute resolution** that started to develop in 1990`s in the USA and came to conquer Europe in the 21st century. One of the first steps for using of online mediation in EU was the adoption of Regulation of the European Parliament and of the European Council of Regulations on online dispute resolution

[16] *O mediatsyiyi ili kak bistro razreshyt konflikt bez obrascheniya v sud. Ukrayinskiyi tsentr mediatsyyi pri Kievo-Mogilyanskoi biznes shkole*, Lviv 2015, p. 58–59.

for consumer disputes dated May 21, 2013[17]. As K. Mania notes, the jurisprudence provides for two meanings of the term "online mediation": the first underlies that the dispute was created online and the second means that online tools will be used to settle the dispute[18]. We agree with the author that the second meaning shall be favoured.

J.W. Goodman has outlined the following types of online mediation services:

- *fully automated cyber-negotiation* – where the dispute is settled with the help of software. One party of the dispute initiates a procedure by logging into the services and sending an offer to the adverse party. The service will then notify the adverse party about the dispute and offer to reply to the offer sent. If the adverse party agrees to the procedure, he or she is allowed to send a reply to the initial offer. The computer software automatically compares the offer with the reply and sends the parties a notification on whether they have a conclusion or are about to conclude. The examples of such service shall be:
- *cyber-mediation using sophisticated software and a neutral third party facilitator* – where a professional facilitator helps the parties to enter the data on the preferences of each party into the website. After this stage is completed the software uses the data to develop settlement packages for the parties to consider. Professional facilitator helps the parties to consider the offers;
- *traditional mediation where sessions and conference are made with the use of electronic communication* – e-mailing, Skype, instant messages etc.[19].

Online mediation can be a great option for entertainment industry because it can be carried out even if the parties to the dispute appear

[17] Regulation (EU) № 524/2013 of the European Parliament and of the Council on online dispute resolution for consumer disputes of 21 May, 2013. Retrieved June 15, 2016 from: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0524&-from=EN.

[18] K. Mania, *Online dispute resolution: The future of justice*, "International Comparative Jurisprudence", Volume 1, Issue 1, November 2015, p. 79. Retrieved June 15, 2016 from: http://dx.doi.org/10.1016/j.icj.2015.10.006.

[19] J.W. Goodman, *The Pros and Cons of Online Dispute Resolution: An Assessment of Cyber-Mediation Websites*, 2 Duke Law & Technology Review 1–16 (2003), p. 2–5. Retrieved June 15, 2016 from: http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1073&-context=dltr.



to be in different countries (e.g. a dispute between a producer and a performer who is out of the country on concert touring), making it to be a very convenient way of dispute resolution. One may also note the disadvantages of this kind of mediation – it is impersonal (therefore not all the entertainment disputes may be mediated) and depends upon the access of the parties to the Internet.

In order to make online mediation work in Ukraine, it is necessary to establish the legal mechanism allowing conduction of such mediation. Online dispute resolution is one of the most prospective ways of dispute resolution in future, including resolution of disputes in such a specific sphere as entertainment industry.

**Conducted research has allowed to come to the following conclusions:**

1. Mediation is a special type of dispute resolution where a neutral intermediary helps the parties to reach a mutually satisfactory settlement of their conflict.
2. Mediation can be an effective means for dispute resolution in the entertainment industry, because the disputes arising in this sphere require specific knowledge, fast resolution, confidentiality and necessity to maintain good relations with the adverse party.
3. It is necessary to create the mediation center that will consider the disputes in the entertainment sphere. The rules of the newly created center can be formed on the basis of WIPO Mediation Rules.
4. Entertainment lawyers, producers or other specialists in the entertainment sphere can mediate the disputes in show business in Ukraine.
5. The mediation agreement shall include the indication of a mediator; parties to the conflict; order, scope and form of paying of mediation fees and reimbursing the expenses on preparation and conduction of mediation; terms and place of conduction of mediation; other conditions agreed by the parties.
6. There are no requirements for settlement agreement under the current Ukrainian legislation. The experts in Ukraine outline the following ways to complete the mediation process in order to comply with the pieces of law: oral agreement, settlement agreement, agreement named in the civil legislation of Ukraine, amicable agreement.

7. Online dispute resolution is one of the most prospective ways of dispute resolution in future, including resolution of disputes in such a specific sphere as entertainment industry.

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# INSOLVENCY IN AMENDED BANKRUPTCY LAW[1]

## Historical overview of the concept of insolvency

Article 10 of the act of Bankruptcy and Reorganisation Law[2] of 28 February 2003 says that bankruptcy is declared on a debtor that became insolvent. Pursuant to Article 11(1) of the said act in its version valid until 1 January 2016, a debtor was considered insolvent if he did not pay his due and payable liabilities, and as of 6 April 2009 a debtor was considered insolvent if he did not pay his due and payable cash liabilities[3]. Apart from the insolvency related to current financial liquidity the legislator introduced the concept of insolvency connected with excessive debt of a given entity. Pursuant to Article 11(2) of the act of 28 February 2003, a debtor that is a legal person or organisational unit without legal status that obtains legal capacity under a separate act is also considered insolvent when his liabilities exceed the value of his property, even if he repays these liabilities on a current basis. The conditions of insolvency defined in such a way should be supplemented with the provisions of Article 12 of the said act, under which a court can dismiss a bankruptcy petition if the delay in the payment of liabilities does not exceed three months and the sum of unpaid liabilities does not exceed 10% of the balance sheet value of the company. In accordance with the literal wording of the said article, the decision whether to accept or dismiss the bankruptcy petition is at the court's discretion.

[1] Amended by the act of 15 May 2015 (Journal of Laws 2015 item 978), the amendment became effective on 1 January 2016.
[2] Journal of Laws 2003 № 60 item 535.
[3] Journal of Laws 2009 № 53 item 434.

Throughout the years of application of the act of Bankruptcy and Reorganisation Law interpretation of the defined concept of insolvency[4] was changing. Initially, both the judicial decisions and the doctrine said in a vast majority of cases that failure to pay the liabilities of low value meant insolvency of a given entity. Insolvency was linked not with the actual condition of the property of a given debtor, but with his behaviour manifested with discontinuation of debt repayment[5]. It should be emphasised that the reason of failure to repay specific liabilities is of no importance.

We speak about insolvency when the debtor does not have funds for repayment or when he does not pay his liabilities for any other reason, even if it's the will to cause his business partner's insolvency or some other irrational reason[6]. In 2011 the Supreme Court expounded the concept of insolvency by reference to the permanence of failure to repay liabilities by a given debtor. In accordance with the third thesis of the said ruling, 'Short-term suspension of debt repayment resulting from temporary difficulties is not a basis for declaring bankruptcy as we speak about insolvency in the meaning of Article 11(1) of Bankruptcy and Reorganisation Law only when the debtor does not pay most of his liabilities due to lack of funds for a longer period of time[7]'. This model of interpretation of the concept of insolvency was adopted by most judges[8]. Arguments in favour of such understanding of the provision were arguments concerning its purpose and function – it says that a short-term failure to pay one's cash liabilities is not a basis for declaring bankruptcy, and only lack of funds that causes the entity's failure to pay most of its cash liabilities is. Moreover, the expression 'fails to pay' used in the provision is to imply a permanent character of non-repayment of debt. Although it has to be said that the interpretation of the Supreme Court presented in the ruling of 19 January 2011 is common-sense and well justified, it met with legitimate and justified criticism.

[4] In the meaning of lack of current financial liquidity (Article 11(1) of the Act of 28 February 2003 on Bankruptcy and Reorganisation Law in the wording valid until 1 January 2016).

[5] For example: Judgment of Provincial Administrative court in Bydgoszcz dated 14 July 2009 passed under file number I SA/Bd 301/09 (Lex 536936); Judgment of Provincial Administrative court in Bydgoszcz dated 8 September 2009 passed under file number I SA/Bd 203/09 (Lex 560426); Judgment of Provincial Administrative court in Lódź dated 20 July 2010 passed under file number I SA/Łd 224/10 (Lex 673733); P. Zimmerman, *Prawo upadłościowe i naprawcze. Komentarz*, Warszawa 2015, pp. 21–23, 25–27; R. Adamus in: *Prawo upadłościowe i naprawcze*, ed. A. Witosz, A.J. Witosz, Warszawa 2014, pp. 77–78, 91–92.

[6] F. Zedler in: *Prawo upadłościowe i naprawcze. Komentarz*, ed. A. Jakubecki, F. Zedler, Kraków 2006, p. 47.

[7] Judgment of Supreme Court dated 19 January 2011 r. passed under file number V CSK 211/10 (Lex 738136).

[8] For example: Judgement of Court of Appeal in Katowice dated 12 September 2013 passed under file number V ACa 50/12 (Lex 7531604), Decision of Supreme Court dated 13 May 2011 passed under file number V CSK 352/10, Judgment of Provincial Administrative court in Warsaw dated 5 December 2011 passed in a case with file number III SA/Wa 856/11.



The doctrine emphasised that even though the definition of insolvency specified in Article 11 may seem too rigorous and might thus infringe the rights of debtors, the wording of the provision with regard to definition of the concept of insolvency was unambiguous. Therefore, it's the legislators that should change the content of the provision, and not the judiciary by means of interpretation[9]. Also the judicial practice did not fully share the interpretation of the concept of insolvency presented by the Supreme Court. The Court of Appeal in Wroclaw in a judgement dated 14 February 2013 said that '... In accordance with the wording of section 1 of this article, a debtor is insolvent if he does not pay his due and payable cash liabilities. According to this definition every failure to pay one's liability in due time will lead to a conclusion that the debtor can be found insolvent. It does not matter here why he does not pay his due and payable liabilities, how big the delay is, or how big the debt is in comparison with the level of his assets...'[10]. Apart from lack of financial liquidity, the legislators said that a given entity is insolvent when its liabilities exceed the value of its property even if it pays these liabilities on a current basis. This definition is connected with excessive debt of a given entity. It should be emphasised here that even the legislators observed that this condition was of much less importance than insolvency understood as lack of finan-

[9] For example: P. Zimmerman, *Prawo upadłościowe i naprawcze. Komentarz*, Warszawa 2015, p. 26; D. Popłonyk, *Glosa do wyroku Sądu Najwyższego z dnia 19 stycznia 2011 roku*, Czasopismo Krajowej Izby Syndyków Fenix.pl, 2011/5(6); M. Pietruszyńska, P. Zimmerman, *Trwałość zaprzestania spłaty długów a stan niewypłacalności – powrót do źródła?*, "Przegląd Prawa Handlowego" 2013/2.

[10] Judgement of the Court of Appeal in Wroclaw dated 14 February 2013 passed under file number I ACa 24/13 (Lex 1313462).

cial liquidity. This fact was noticed even by the legislators, who were going to repeal Article 11(2) of the act of 28 February 2003 of Bankruptcy and Reorganisation Law. In a justification of a bill that was not passed eventually it was said that 'Repeal of section 2 of Article 11 is connected with the fact that in practice bankruptcy is declared only because of non-payment of the cash liabilities by the debtor'[11]. It should be said that the condition of excessive debt in the wording from before the amendment deserved justified criticism. First of all, the legislators did not specify the method of evaluation of the condition of excessive debt. Obviously, such a condition may be evaluated in several ways, e.g. on the basis of market value or on the basis of balance sheet value, which may differ considerably. Secondly, it should be stressed that the debt-related definition of insolvency in the previous form did not take into account in any way the business trading practice. In a situation when a given entity is going to invest using for example a bank loan, it may turn out insolvable (in the meaning of the presented definition) before it begins its activity in practice. It was obvious thus that the condition of excessive debt should be connected with the occurrence of a situation when the payment of due and payable cash liabilities is threatened. Unfortunately, this postulate could by no means be combined with the wording of the article.

## Lack of financial liquidity as a condition of insolvency in amended bankruptcy law

Under the act of 15 May 2015 the name of the act was changed from Bankruptcy and Reorganisation Law to Bankruptcy Law. This change was connected with modification of subject matter of the regulation and repeal of the provisions concerning reorganisation proceedings. At the same time the amending act introduced new definitions of the concept of insolvency both in the liquidity variant (loss of payment capability) and in the debt variant (dominance of cash liabilities over property). Pursuant to Article 11(1) a debtor is insolvent if he lost the ability to pay his due and payable cash liabilities. Article 11(1a) stipulates a presumption according to which it is presumed that the debtor

[11] Sejm paper 1845 of the 5th Term Sejm.



lost the ability to pay his due and payable cash liabilities if the delay in payment of cash liabilities is longer than three months.

The doctrine emphasises that the changed definition of insolvency introduced by the amending act of 15 May 2015 leads to the effect that fits the economic approach to this concept, its popular understanding, and also its intuitive understanding by entrepreneurs[12]. In accordance with the amended wording of the article, it is no longer unclear whether the sole fact of lack of payment does not mean that a given debtor is insolvent, which was questioned in the article's wording from before the amendment[13]. Moreover, it seems that the legislators decided that the condition of lack of financial liquidity causing the loss of capacity to pay the due and payable cash liabilities must be permanent and definitive. The word 'loss' indicates clearly that this condition may not be temporary and reversible. It seems also that bankruptcy will not be declared on a company whose analysis of economic standing suggests that it will almost certainly lose the ability to pay its cash liabilities in the near future, although it pays its cash liabilities on a current basis. It should be emphasised that in the present legislation the condition of insolvability is connected only with failure to pay cash liabilities. Pursuant to Article 11(1a) it is presumed that the debtor lost his capacity to pay his due and payable cash liabilities if the delay in payment of his cash liabilities exceeds three months. It should be said that this presumption is challengeable, and the evidence regarding financial liquidity incriminates the debtor.

The debtor may rebut the stipulated presumption in a number of ways. He may prove that he has valid and binding commercial agreements and will soon receive sums that will allow him to pay back his debts in the near future[14]. Secondly, a debtor may claim that he has financial resources, but invested them and will obtain high profits in the relatively near future[15]. Finally, a debtor may prove that he

[12] P. Filipiak in: *System Prawa Handlowego*, vol. 6, *Prawo Restrukturyzacyjne i Upadłościowe*, ed. A. Hrycaj, A. Jakubecki, A. Witosz, Warszawa 2016, p. 681; also S. Gurgulu, *Prawo Upadłościowe. Prawo Restrukturyzacyjne. Komentarz*, Warszawa 2016, p. 41.

[13] R. Adamus, *Prawo restrukturyzacyjne. Komentarz*, Warszawa 2015, pp. 40–41.

[14] P. Filipiak in: *System Prawa Handlowego*, vol. 6, *Prawo Restrukturyzacyjne i Upadłościowe*, ed. A. Hrycaj, A. Jakubecki, A. Witosz, Warszawa 2016, p. 690.

[15] Decision of the Supreme Court of 14 June 2000 issued under file number V CKN 1117/2000.

owns a large property that he intends to sell in the near future and allocate the funds obtained from sales to payment of his debts. Last, but not least, obviously, a debtor may also explain that lack of payment is caused by non-economic reasons. Pursuant to Article 12a of the amended act of Bankruptcy Law, court will dismiss a bankruptcy petition filed by a creditor if the debtor proves that the debt is entirely disputable, and the dispute occurred between the parties before the bankruptcy petition was filed. Bearing in mind the content of the abovementioned article and the provisions of Article 11 of the act of Bankruptcy Law, the author of this paper claims that it is sufficient if a creditor files a petition for declaring its debtor bankrupt and proves that this debtor defaults on the payment of only one liability for over three months. Such a conclusion is drawn from the fact that the amended act of Bankruptcy Law does no longer connect insolvency with a simple failure to pay the due and payable cash liabilities, but with the loss of financial liquidity, which results in non-payment of debts. Moreover, Article 12a mentions liability in the singular, and not in the plural. Presentation of such a conclusion is important with regard to the fact that before the amendment both the doctrine and judicial decisions said that a given debtor must default on the payment of at least two different cash liabilities. Such a conclusion derives from the fact that the literal wording of the provision mentioned failure to pay one's liabilities, and not liability[16]. Meanwhile, capacity to pay one's liabilities may be lost regardless of their number.

## Excessive debt as the condition of insolvency in amended bankruptcy law

Pursuant to the amended Article 11(2) of Bankruptcy Law, a debtor that is a legal person or organisational unit without legal status that obtains legal capacity under a separate act is also insolvent when his cash liabilities exceed the value of his property for over twenty-four months. In subsequent sections the legislators stipulated a presumption under which it is presumed that the debtor's cash liabilities exceed the

[16] R. Adamus in: *Prawo upadłościowe i naprawcze*, ed. A. Witosz, A.J. Witosz, Warszawa 2014, pp. 90–91.



value of his property if according to the balance sheet statement his liabilities, excluding reserves for liabilities and liabilities towards affiliates, exceed the value of his assets for longer than twenty-four months.

It should be emphasised that in accordance with section 6 of this article a court may dismiss a bankruptcy petition if there is no threat that the debtor will lose his capacity to pay his due and payable cash liabilities in the near future. What is important, the legislators say in the justification for the bill of Restructuring Law that the debt-related condition of insolvability is only auxiliary to the liquidity-related condition. As the legislators decided to leave the condition of excessive debt as one of the reasons of insolvability, a realistic possibility, the right instrument should be indicated for defining whether the condition of excessive debt occurs, and if so, when it occurs. Both in legal and economic theory the term value (with regard to property) is used with regard to various contexts: exchange, use, asset, accounting, liquidation, tax, cadastral, replacement, current (discounted), zero, negative, pledge[17]. Depending on the choice of the method of estimation of property value, the final effect may vary. In accordance with the bill of Restructuring Law, the value of property should not be estimated on the basis of balance sheet value but on the basis of real (selling) value if we assume that the business activity will be continued. Judicial decisions based on the said article before the amendment supported this line of reasoning. The Provincial Administrative Court in Bydgoszcz found that Article 11(2) of the act of Bankruptcy and Reorganisation Law could not be interpreted only on the basis of balance sheet, which only sorts the entrepreneur's property according to the sources of his financing[18]. Such an opinion that the value of entrepreneur's property should be estimated in accordance with market value seems to be shared by a vast majority of representatives of the doctrine[19].

[17] S. Gurgul, *Prawo Upadłościowe. Prawo Restrukturyzacyjne. Komentarz*, Warszawa 2016, p. 43.

[18] Judgment of Provincial Administrative court in Bydgoszcz dated 14 July 2009 passed under file number I SA/Bd 301/09 (Lex 536936).

[19] P. Zimmerman, *Prawo upadłościowe i naprawcze. Komentarz*, Warszawa 2015, p. 27; K. Osajda, *Uwagi o pojęciu niewypłacalności w świetle nowelizacji prawa upadłościowe*, "Przegląd Prawa Handlowego" 2016/1; P. Filipiak in: *System Prawa Handlowego*, vol. 6, *Prawo Restrukturyzacyjne i Upadłościowe*, ed. A. Hrycaj, A. Jakubecki, A. Witosz, Warszawa 2016, p. 699.

Some representatives of the doctrine notice, however, that the method of evaluation of the property's value according to selling value has numerous flaws and they opt for the use of the balance sheet method[20]. Moreover, according to some authors, the legislators have not stated explicitly what method should be applied to estimate the value of the debtor's property[21]. According to the author, the legislators stipulated a presumption that if two successive balance sheet statements indicate that the value of liabilities exceeds the value of assets, it can be presumed that a given debtor became insolvent. It is a challengeable presumption, though. In Article 11(2) the legislators do not use the concepts of assets and liabilities, but the concept of cash liabilities and property value. Bearing in mind the wording of this article, it should be considered that the legislators said explicitly that the value of the debtor's property should be estimated according to the selling value, but if the balance sheet method indicates insolvability, the debtor may adduce evidence in this regard. Simultaneously, the author claims that disputable liabilities should be taken into account if they were entered in the debtor's books and included among tax deductible expenses.

## Conclusions

First of all, it should be emphasised that the Polish legislators did not introduce an explicit definition of the concept of insolvability into the Polish legislation when amending the act of Bankruptcy Law. With regard to the above, the concept of insolvency is used for example in the civil code, cooperative law, banking law, criminal code, the law on the protection of employee claims in case of the employer's insolvability, or in the code of commercial companies. Secondly, the new approach in which insolvability is the condition of the company's bankruptcy

[20] A. Cybulska, T. Biel, *Metoda wyceny majątku przedsiębiorcy w kontekście nowego brzmienia przesłanki niewypłacalności wynikającej z nadmiernego zadłużenia*, "Doradca restrukturyzacyjny" 2015/2.

[21] K. Osajda, *Uwagi o pojęciu niewypłacalności w świetle nowelizacji prawa upadłościowe*, "Przegląd Prawa Handlowego" 2016/1; A. Cybulska, T. Biel, *Metoda wyceny majątku przedsiębiorcy w kontekście nowego brzmienia przesłanki niewypłacalności wynikającej z nadmiernego zadłużenia*, "Doradca restrukturyzacyjny" 2015/2.



should meet with partial criticism. The author thinks that primarily the concept of insolvability connected with excessive debt should be eliminated completely. In the wording from before the amendment, even though it was of marginal importance, the meaning of this provision did not take into account the business trading practice. In the wording after the amendment one can expect complete marginalisation of the excessive debt condition. First of all, a debtor may prove effectively that the condition in which his cash liabilities exceeded the value of his property for 24 months was not a continuous process, and in the meantime the value of his property was even higher than the value of his liabilities at times. Secondly, bearing in mind the fact that both the legislators and many representatives of the doctrine say that the value of a company's property should be estimated according to market value, we must answer the question who will estimate the value of this property and establish that the condition of excessive debt lasts for over 24 months. This issue is important as pursuant to Article 30a of Bankruptcy Law, the proceedings concerning declaration of bankruptcy do not involve the evidence in the form of expert testimony. It seems that a temporary insolvency administrator or compulsory administrator securing the property that provide information on the debtor's financial standing upon the court's request do not have such competences. Bearing the abovementioned arguments in mind, and with regard to the postulate of creating clear and applicable law, the condition of insolvency related to excessive debt should be removed from the Polish legislation.

Discussing the conclusions drawn from the changed definition of liquidity-related insolvability, it should be indicated first of all that in 2015 the Polish courts declared 741 entities bankrupt, while in 2014 there were 823 bankruptcies, and in 2013 - 883[22]. For comparison, there were 26,300 bankruptcies in Germany in 2013[23]. These figures do not mean that the Polish economy has better foundations than the German one. This difference means that despite grounds for declaring companies bankrupt, it is not practiced often in Poland although there is such a need. The phenomenon of the so-called payment gridlock is so common and knowledge of it is notorious, so this thesis needs

[22] Retrieved July 8, 2016 from: www.coface.pl.

[23] Retrieved July 8, 2016 from: www.credireform.pl.

no justification. Therefore, the author claims that the legislators were right to connect the statutory definition of insolvability with the financial standing of the debtor, but in a too radical way. A debtor that now defaults on payment for over three months will be able to rebut the presumption on the basis of which he lost the capacity of payment of his due and payable cash liabilities in a relatively easy way, and it will be very hard for the creditor to respond to their arguments (without knowledge of the debtor's internal situation). At the same time, a creditor who files a bankruptcy petition will mostly justify it with the presumption connected with a three-month default on payment of a cash liability. It will be extremely difficult for a creditor to prove the debtor's permanent loss of capacity to pay his liabilities because of their lack of sufficient knowledge of the debtor's financial standing. With regard to the above arguments, the author is of the opinion that the definition of insolvability should be constructed in such a way so that it takes into consideration the debtor's financial standing and that the legislators should modify this regulation slightly. It should be added as a side note that according to the author, unreliable debtors should be aware of the possibility of imposing sanctions on them in the form of declaration of their bankruptcy. Modification should consist in broadening the definition of insolvability by inclusion of the situation in which the debtor not only already lost his capacity to pay his cash liabilities, but also may lose this capacity in the near future. Alternatively, the stipulated presumption should be unchallengeable if the default on payment of cash liabilities exceeding three months concerns a large part of the debtor's liabilities. Rigorous as this postulate may sound, it should be emphasised that it is adjusted to the present business practice in Poland. The situation of permanent default on payment of liabilities and the scope of this phenomenon is dangerous for the economy. Therefore, the legislators should prevent this situation categorically.

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# RECENT DEVELOPMENT IN THE POLISH LAW OF SUCCESSION – LIABILITY FOR INHERITANCE DEBTS

## Introduction

The law of succession in Poland is becoming increasingly important. The level of complications of proprietary relations of further testators is growing. As a result of economic changes from 1989, along with increased access to credit, the inheritance often includes significant debts. Again and again there are situations where testators amass huge debts at the end of their life. The indebtedness results in consequences that are unexpected and heavy for the heirs[1]. The regulation on liability for inheritance debts requires the opposing interests of the inheritance creditors and of the heirs to be dealt with in a balanced way.

Already at the moment of adopting legal solutions concerning liability for inheritance debts accepted in the Polish Civil Code (further, the PCC)[2], the representatives of the doctrine of Polish private law warned against the regulation, raising concerns about the consequences of the heirs' silence and the problem of accepting or rejecting an inheritance[3]. Against the background of the provisions in force until 17 October 2015, the imperfections of the adopted compromise solu-

[1] M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności za długi spadkowe w prawie polskim*, [in:] M. Boratyńska (ed.), *Ochrona strony słabszej stosunku prawnego. Księga jubileuszowa ofiarowana Profesorowi Adamowi Zielińskiemu*, Warszawa 2016, p. 432.

[2] Civil Code from 23 April 1964 (Unified publication of law in J.L. 2016, item 380).

[3] See, among other things, K. Przybylowski, *Ukształtowanie zasad dotyczących odpowiedzialności za długi spadkowe w polskim prawie cywilnym*, "Studia Cywilistyczne", t. XIII–XIV, Kraków 1969, pp. 247–248.

tion[4] in accessible methods of protecting heirs against the consequences of the testator's indebtedness started to become apparent[5]. It seems that the amendment introduced by the Law on Amending the Civil Code and Other Acts from 20 March 2015[6] meets these aims better than the law in force so far, increasingly bringing solutions to legal problems arising in the latest jurisprudence. This article discusses the significant changes in the field of liability of inheritance debts following the amendments that came into force on 18 October 2015. This article limits itself to exploring just the liability of heirs for inheritance debts[7].

## Hitherto regulations on liability for inheritance debts under the Polish Civil Code from 1964

It is worth mentioning that, under the Polish law of succession, according to Article 925 of the PCC, an heir acquires the inheritance at the moment of opening the inheritance[8], but the acquisition is not definite. According to Article 1012 of the PCC, the heir can either accept the inheritance without limited liability for debts (simple acceptance), or accept the inheritance with limited liability (acceptance with the benefit of inventory) or else reject the inheritance. An heir who rejects the inheritance is excluded from the succession as if he had not

[4] M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności*, p. 424. About the sources of the hitherto rule of unlimited liability for inheritance debts, see G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców, czyli skoro miało być tak dobrze, dlaczego jest tak źle?*, [in:] M. Zalucki (ed.), *Egzekucja z majątku spadkowego. Ograniczona i nieograniczona odpowiedzialność za długi spadkowe*, Warszawa 2016, p. 146.

[5] M. Pazdan in: K. Pietrzykowski (ed.), *Kodeks cywilny*, Tom II, *Komentarz, Art. 450–1088. Przepisy wprowadzające*, Warszawa 2015, p. 1135; E. Skowrońska-Bocian, W. Borysiak in: B. Kordasiewicz (ed.), *System Prawa Prywatnego*, Tom 10, *Prawo spadkowe*, Warszawa 2013, pp. 625–626.

[6] J.L. 2015, item 539.

[7] About liability for inheritance debts, see futher E. Macierzyńska-Franaszczyk, *Odpowiedzialność za długi spadkowe*, Warszawa 2014, pp. 184–215; E. Skowrońska-Bocian, W. Borysiak in: B. Kordasiewicz (ed.), *System Prawa Prywatnego*, Tom 10, *Prawo spadkowe*, Warszawa 2015, pp. 651–793.

[8] M. Pazdan in: K. Pietrzykowski (ed.), *Kodeks cywilny*, p. 1129. Into account should be taken also Art. 924 of the PCC, which states that the inheritance is opened at the moment of the death of the deceased.



lived until the opening of the inheritance[9]. The acquisition of inheritance becomes final also when there are circumstances determining that the heir has made such a declaration, according to Article 1015 § 2 sentence 1 of the PCC[10].

The liability of an heir for inheritance debts differs in the period before the acceptance of inheritance and after it. Significant changes are also brought by the distribution of the inheritance[11]. Concerning liability for inheritance debts, it is also important if there is more than one heir who inherits. According to the rules from Article 1030 of the PCC, until the inheritance is accepted, the heir is liable for the debts only with the inheritance assets[12], and the inheritance assets are separated from the personal assets of the heir. After the acceptance the liability of an heir covers all the assets, both personal and inherited[13].

The acceptance of inheritance occurs either by making a relevant declaration or as a result of the legal fiction provided in Article 1015 § 2 of the PCC, whereby it can be interpreted that an heir has made such a declaration. According to Article 1015 § 1 of the PCC, a declaration on the acceptance or rejection of inheritance can be made in the period of six months from the day on which the heir learned about the appointment to inherit[14]. Pursuant to Article 1018 of the PCC, the declaration on accepting or rejecting an inheritance can be made either before a court or before a notary. The declaration can-

[9] Art. 1020 of the PCC; further see G. Gorczyński, O ograniczonej odpowiedzialności spadkobierców, p. 140.

[10] Art. 1015 § 2 sent. 1 of the PCC in the wording till 17 October 2015: "The non-declaration by a heir in the time limit set in § 1 is deemed to be simple acceptance of inheritance".

[11] See Art. 1034 of the PCC. Due to the frame of this volume, the liability for the inheritance debts after the distribution of inheritance cannot be expanded upon in this paper.

[12] Art. 1030 sent. 1 of the PCC; E. Macierzyńska-Franaszczyk, *Wybrane problemy odpowiedzialności za długi spadkowe w prawie polskim – stan obecny i potrzeba zmian*, [in:] P. Stec, M. Zalucki (ed.), *50 lat kodeksu cywilnego. Perspektywy rekodyfikacji*, Warszawa 2015, p. 418; G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców*, pp. 149–150. It is known as liability cum viribus hereditatis.

[13] See fn. 24.

[14] Learning about the title of the appointment to inheritance in the case of intestate succession is mainly connected with the day on which the heir became aware of the testator's death. Further see E. Skowrońska-Bocian, *Odpowiedzialność za długi spadkowe. Komentarz do zmian 2015*, Warszawa 2016, p. 76.

not be withdrawn. It can be made either orally or in writing with an officially certified signature. A declaration made under a condition or setting out a time limit is invalid. It can be submitted by a proxy[15].

Article 1015 § 2 sentence 1 of the PCC states that if a heir does not make any declaration within six months from learning about the appointment to inherit, then it is deemed to be simple acceptance of inheritance. The law sets out some exceptions to this rule. Not making a declaration for some categories of heirs results in the acceptance of the inheritance with the benefit of inventory. These exceptions refer to the following categories of heirs: an heir who does not have the full capacity for legal acts, an heir with respect to whom there are grounds for full incapacitation or a legal entity[16], as well as the State Treasury or municipality[17].

From the moment of accepting the inheritance, the heir is liable for the debts with his all assets, consisting of both the personal as well as the inherited assets. This regulation does not determine the scope of liability, which can be either unlimited or limited for some assets.

### Unlimited liability for inheritance debts

Unlimited liability for inheritance debts with the whole inherited and personal assets is a result of the simple acceptance of inheritance, in the form of a declaration or as a result of the legal fiction provided by Article 1015 § 2 of the PCC.

[15] About the declaration on the acceptance or rejection of an inheritance, see G. Gorczyński, *Oświadczenie o przyjęciu i odrzuceniu spadku – uwagi de lege ferenda*, [in:] A. Dańko-Roesler, J. Jacyszyn, M. Pazdan, W. Popiołek (ed.), *Rozprawy z prawa prywatnego. Księga Pamiątkowa dedykowana Profesorowi Aleksandrowi Oleszcze*, Warszawa 2012, p. 136 et seq; M. Pazdan in: K. Pietrzykowski (ed.), *Kodeks cywilny*, pp. 1138–1139.

[16] Art. 1015 § 2 sent. 2 of the PCC in the wording till 17 October 2015. This rule applies also to the organisational entities without legal personality, which obtain legal capacity by the statute, according to Art. $33^1$ of the PCC (in the literature, known as disabled legal persons). M. Pazdan in: K. Pietrzykowski (ed.), *Kodeks cywilny*, p. 1134; W. Borysiak in: K. Osajda (ed.), *Kodeks cywilny. Komentarz*, t. III, *Spadki*, Warszawa 2013, p. 817; E. Macierzyńska-Franaszczyk, *Odpowiedzialność za długi spadkowe*, p. 248.

[17] These subjects on the basis of Art. 1023 of the PCC. This consequence of limited liability for inheritance debts also occurs where there are no declaration of that person, and the consequences of the legal fiction of acceptace with the benefit of inventory on the basis of Art. 1015 § 2 of the PCC in the wording till 17 October 2015. See further G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców*, p. 139, footnote 6.



In this context, it is worth mentioning the regulations concerning defects in a declaration of intent. In the event that the declaration on accepting or rejecting an inheritance has been made under the influence of an error or threat, the law concerning defects in a declaration of intent[18] applies, with some modifications provided in Article 1019 of the PCC. The avoidance of the legal effects of the declaration should be made before a court, and the heir should declare whether and how he accepts the inheritance, or rejects it. The avoidance of the legal effects of a declaration on the acceptance or rejection of an inheritance also requires approval from the court.

An heir who failed to make any declaration within the time limit, due to being under the influence of an error or threat, can in this way avoid the legal consequences of missing the deadline. The passivity of heirs is often a result of being unaware of the inheritance indebtedness. In such a situation, under the law in force until 17 October 2015, the heirs tried to avoid the results of the legal fiction provided in Article 1015 § 2 of the PCC by referring to an error in the legal act, if the error was objectively and subjectively essential. An error can be, for example, in the person of the testator or as to the assets of the inheritance. The same refers to the possibility of avoiding the legal effects of failing to submit any declaration in the time limit because of being under the influence of an error[19].

The interpretation of the provisions concerning the error was subject to several judgements of the Polish Supreme Court[20], as well as the subject of much discussion in the doctrine of Polish private law[21]. The judgements of the Supreme Court on this topic have, in recent

[18] Art. 84, 86 and 88 of the PCC. About the defects in a declaration of intent, see M. Pazdan in: K. Pietrzykowski (ed.), *Kodeks cywilny*, pp. 1139–1142.

[19] M. Pazdan in: K. Pietrzykowski (ed.), *Kodeks cywilny*, p. 1141.

[20] See judgement of the Supreme Court from 30 June 2005 (IV CK 799/04), Judgements of the Civil Chamber of the Supreme Court – OSNC 2006/5/94; judgement of the Supreme Court from 18 March 2010 (V CK 337/09), LEX № 677786; judgement of the Supreme Court from 1 December 2011 (I CSK 85/11), LEX № 1147725; judgement of the Supreme Court from 5 July 2012 (IV CSK 612/11), OSNC 2013/3/39; judgement of the Supreme Court from 29 November 2012 (II CSK 172/12), LEX № 1299156.

[21] See T. Jasiakiewicz, *Uchylenie się od skutków złożonego pod wpływem błędu oświadczenia woli o przyjęciu spadku a odpowiedzialność za długi spadkowe*, "Przegląd Prawa Handlowego" 9/2013, pp. 42–46; M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności*, p. 424.

years, been were quite unfavourable to heirs. In particular, the right to claim an error was refused if the heirs did not exercise due diligence in determining the real standing of the inheritance assets.

It was also controversial in the doctrine of Polish private law as to whether an heir can invoke an error as to the law. This question was subject to the judgement of the Supreme Court of 29 November 2012 (V CSK 171/12)[22]. The Supreme Court stated that, in light of Article 84 of the PCC, there are no obstacles to recognising an error as a legally significant not only if it concerns the facts, but also if it concerns the law, where the error is in connection with the content of a legal act and is significant[23].

### Limited liability for inheritance debts

Limited liability for inheritance debts applies when accepting an inheritance with the benefit of inventory. The heir is then liable for the inheritance debts up to the value of the inheritance assets determined in the inventory[24]. Limited liability for inheritance debts also apply when the heir is an individual who does not have the full capacity for legal acts, where there are grounds for the heir's full incapacitation, or the heir is a legal entity[25], as a result of the legal fiction from Article 1015 § 2 sentence 2 of the PCC on a failure to declare the acceptance of inheritance in the time limit, as well as where the heir is the State Treasury or municipality (Article 1023 of the PCC). Similarly, if one of joint heirs accepts the inheritance with the benefit of inventory, it is presumed that the heirs who did not make any declaration within the time limit accepted the inheritance also with the benefit of inventory[26].

[22] LEX № 1294475.

[23] In this judgement, the Supreme Court recognised the error as to the influence of the system of separate estates in matrimony on the inheritance order as a potentially legally significant error.

[24] Art. 1031 § 2 sent. 1 of the PCC. And not only to part of the inheritance the inherited by the heir. See further G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców*, p. 150. It is known as liability pro viribus patrimonii (pro viribus hereditatis).

[25] See fn. 16.

[26] Art. 1016 of the PCC. See also fn. 17.



In order to determine which of the assets comprise the inheritance, and to estimate its value, an inventory is drawn up[27]. The inventory can be drawn up either *ex officio* by the court or upon a motion (Article 637 of the Polish Code of Civil Procedure in the old wording). The inventory is drawn up by a judicial enforcement officer[28]. The limitation of liability for inheritance debts does not apply if the heir deceitfully fails to include in the inventory some objects belonging to the inheritance, or included in the inventory non-existent debts[29].

## The Act on Amending the Civil Code and Other Acts, of 20 March 2015

The combination of the legal construction whereby an heir acquires the inheritance by virtue of the law under the legal fiction from Article 1015 § 2 of the PCC in connection with the passivity of the heir causes the possibility of him being responsible for debts considerably surpassing the value of his full assets. The imperfection of this legal solution in force was mentioned in the doctrine by K. Przybyłowski[30], J. Gwiazdomorski[31] and E. Drozd[32]. Changes in this field and the introduction of limited liability were postulated in the literature by J. Stobienia[33] and E. Skowrońska[34], and in the latest literature

[27] The procedure of drawing up an inheritance inventory was regulated in Art. 637 et seq. of the Polish Civil Procedure Code (J.L. 2014, item 101 with amendments; further CPC) and the Regulation of Ministry of Justice from 1 October 1991 on the detailed proceedings of securing of inheritance and drawing up of an inheritance inventory (J.L. 1991, № 92, item 411).

[28] Or another authority according to § 2 of the Regulation from 1 October 1991 on the detailed proceedings of securing of inheritance.

[29] Art. 1031 § 2 sent. 2 of the PCC.

[30] K. Przybyłowski, *Ukształtowanie zasad dotyczących odpowiedzialności*, pp. 247–248.

[31] J. Gwiazdomorski, *Prawo spadkowe*, Warszawa 1959, p. 96.

[32] E. Drozd in: J.St. Piątowski (ed.), *System Prawa Cywilnego, t. IV, Prawo spadkowe*, Wrocław–Warszawa–Kraków–Gdańsk–Łódź 1986, p. 371.

[33] J. Stobienia, *Realizacja wierzytelności wierzycieli spadkodawcy w prawie polskim*, Warszawa 1981, p. 164.

[34] E. Skowrońska, *Odpowiedzialność spadkobierców za długi spadkowe*, Warszawa 1984, pp. 166–169.

on the Polish law of succession by E. Macierzyńska-Franaszczyk[35]. This problem was recognised in the latest jurisprudence of the Supreme Court. Finally, the Act on Amending the Civil Code and Other Acts of 20 March 2015 contains the anticipated amendment concerning liability for inheritance debts[36]. The inventor[37] of the private inventory list and author of main of the implemented solutions[38] is Doctor G. Gorczyński from the University of Silesia in Katowice, as an active Member of the Polish Codification Commission of Private Law, in the Working Group on Law of Succession.

### Limited liability for inheritance debts as a rule

The most significant amendment concerns the results of the heir's silence – i.e. failing to make a declaration on the inheritance within the six-month deadline. According to the amended Article 1015 § 2 of the PCC[39], an heir who does not make any declaration on accepting or rejecting an inheritance within six months from the day on which he learned about the appointment to inherit is treated as if he had accepted the inheritance with the benefit of inventory. As a result, Article 1016 of the PCC had to be repealed.

The legal fiction on accepting an inheritance with the benefit of inventory under Article 1015 § 2 of the PCC in the new wording means that now unlimited liability for inheritance debts will be an exception. In order to apply the exception, the heir has to make i.e. a proper declaration.

[35] E. Macierzyńska-Franaszczyk, *Odpowiedzialność za długi spadkowe*, pp. 257–259 and p. 329.

[36] The bill prepared by the Members of Parliament, along with its explanatory statement, is available at http://www.sejm.gov.pl/sejm7.nsf/PrzebiegProc.xsp?nr=990 [Retrieved 20 May 2016] The bill prepared by the Government, along with its explanatory statement is available at: http://www.sejm.gov.pl/sejm7.nsf/PrzebiegProc.xsp?nr=2707 [Retrieved 20 May 2016].

[37] G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców*, p. 141, footnote 19, p. 142, footnote 20.

[38] About the legislative procedure and the amendments of the projects in the Polish Codification Commission of Private Law, see M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności*, pp. 426–429; G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców*, pp. 147–148.

[39] Art. 1015 § 2 sent. 2 of the PCC in the wording since 18 October 2015: "The non-declaration by a heir in the time limit set in § 1 is deemed to be an acceptance of the inheritance with the benefit of inventory".



### Stocktaking of inheritance – private inventory list and inheritance inventory

Limited liability for inheritance debts requires an assessment of the extent of liability. It is connected with the need to stocktake the inheritance assets. In the hitherto legal order, limited liability for inheritance debts was connected with a requirement to draw up an inheritance inventory[40]. According to the hitherto law, the inventory of inheritance assets was made by the judicial enforcement officer for consideration. This meant additional expenses incurred by the heirs, also involving the expenses on the valuation of inheritance assets by an appraiser.

The lawmaker decided to introduce an institution that will prevent excessive expenses, or at least reduce them. This function will be an alternative to the official inheritance inventory and is known as the private inventory list[41]. The institution of the private inventory list is regulated under amended provisions from 20 March 2015, namely Articles $1031^1$–$1031^4$ of the PCC, as well as an ordinance of the Ministry of Justice, issued on the basis of Article $1031^2$ of the PCC, dated 22 September 2015 on a template for the private inventory list and the manner in which the template is made available[42], which contains an unified template of the private inventory list.

The drawing up of a private inventory list is optional[43], but is encouraged in the regulations setting out the prerequisites for the limited liability for inheritance debts[44]. The inventory list is a private document. It can be drawn up either by the heir accepting the inheritance with the benefit of inventory, or by the absolute legatee or by the executor of the will, and it can be submitted jointly by more than one person.

In the private inventory list, the objects belonging to the inheritance and the objects of absolute legacy should be disclosed with due diligence, stating their value at the moment the opening of inheritance

[40] See Art. 644 of CPC.

[41] K. Osajda, *Wykaz inwentarza – nowa instytucja prawa spadkowego*, "Monitor Prawniczy" 23/2015, pp. 1239–1247.

[42] J.L. 2015, item 1537.

[43] Materiały Komisji Kodyfikacyjnej Prawa Cywilnego, p. 780; M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności*, p. 430.

[44] Especially the new Art. $1031^3$ § 1 of the PCC and Art. 1031 § 2 of the PCC.

and the prices at that time, as well as the inheritance debts and their amount at the moment of the opening the inheritance.

The final addressee of the private inventory list is the court of inheritance[45]. The legislator also provided the possibility to submit the inventory list before a notary[46]. The court of inheritance promptly orders the announcement about the submission of a private inventory list. The announcement includes an instruction on the possibility of anyone with sufficiently good grounds accessing the submitted private inventory list.

It is still possible for legitimate parties to request the court to order an inheritance inventory to be drawn up. The amendment of the law does not change the institution of the inheritance inventory. It still remains an official instrument for collecting information on the content of the inheritance in relations between the heirs, or between them and the inheritance creditors.

### Repayment of inheritance debts

In the case of limited liability for inheritance debts, the main question for the inheritance creditors is the due satisfaction of debts, and to make sure that the amount of liability (the value of inheritance assets) would not be exhausted as a result of satisfying only some of the debts. Polish law does not set out any regulations on the separation of the personal assets of the heir from the inheritance assets, or the liquidation procedure of the inheritance, or the convocation of creditors procedure[47]. It does not provide any rules for the hierarchy of repayment of debts[48]. In this situation, the lawmaker had a difficult task. On the one hand he had to impose on the heirs who would take advantage of the benefit of inventory a duty to exercise due diligence in determining the real standing of inheritance assets[49] and the repayment of inheritance debts, while on the other hand he had to draft a legal mechanism that allows creditors at least to be aware that their interest can be imperilled in connection with the heir's limited liability for inheritance debts.

[45] See the amended Art. $636^3$ § 1 of the CPC; M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności*, p. 430.

[46] Art. $636^3$ § 2 of the CPC in conjunction with Art. $1031^1$ § 1 of the PCC.

[47] The convocation procedure of creditors deals with ascertaining the indebtedness of the inheritance.

[48] Further see E. Skowrońska-Bocian, *Odpowiedzialność za długi spadkowe. Komentarz*, pp. 55–67; P. Księżak, *Dobrodziejstwo inwentarza po nowelizacji kodeksu cywilnego z 2015 r. – aspekty materialnoprawne*, "Kwartalnik Prawa Prywatnego" 4/2015, pp. 900–909.



The legal mechanism of liability for inheritance debts when the inheritance was accepted with the benefit of inventory is regulated by in the new wording of Article 1031 § 2 of the PCC and Article 1032 of the PCC, as well as the newly added Article $1031^1$–$1031^4$ of the PCC. The law does not change the hitherto binding rules of liability for inheritance debts in the event of accepting an inheritance with the benefit of inventory.

Analysing the situation of the creditors in order to protect their justified interest in light of the new legal solutions, the following issues are worth raising[50]. Through the institution of the private inventory list, along with access to submitted lists, the creditors, heirs and other legitimate parties can obtain information about the financial standing after the testator's death[51]. The submission of the private inventory list by an heir starts the order released by the court of inheritance. An heir who submitted an inventory list repays the inheritance debts in accordance with the submitted list. The heir cannot claim a lack of knowledge about inventory lists submitted by other entitled parties, and if it is revealed after the submission of the inventory list that it is incomplete, the heir is obliged to supplement it. This obligation refers to anybody submitting a private inventory list. At the motion of a creditor who possesses written evidence against a testator who was his debtor, the court of inheritance releases an order to draw up an inheritance inventory. After an inheritance inventory has been drawn up, the heir repays the inheritance debts in accordance with the inventory (Article $1031^3$ § 2 of PCC).

Moreover, the legal consequences of accepting an inheritance with the benefit of inventory stated in Article 1031 § 2 sentence 2 of the PCC cease if the heir deceitfully failed to include in the private inventory list any objects belonging to the inheritance or being an object

[49] It means especially due diligence by ascertaining the existence of such debts.

[50] M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności*, pp. 431–432.

[51] For example, about the assets belonging to the inheritance.

of an absolute legacy, or if he did not record them in the inheritance inventory, or deceitfully included in the private inventory list or in the inheritance inventory non-existent debts.

The enacted provisions impose also an obligation on the heir to apply due diligence when repaying inheritance debts, if he wants to take advantage of the limited liability of inheritance debts. The creditors can, thanks to their activity and direct contact with the heirs, inform them about the debts, which then leads to the heir's liability being subject to the amended Article 1032 § 2 of the PCC, rather than Article 1032 § 1 of the PCC, which talks about good faith. It is worth emphasising that, according to the amended Article 1032 § 2 of the PCC, good faith only applies to an heir who did not have any knowledge and, despite due diligence, could not have been aware of the existence of other inheritance debts. As a result of the amendment, the scope of application of Article 1032 § 2 of the PCC is extended and also covers any outstanding debts that the heir should be aware of.

## Conclusions

The legal solutions included in the provisions in force so far have not protected the heirs from unexpected liability for inheritance debts exceeding the value of inheritance assets. The legislator introduced a solution to a social problem, because it is not uncommon for unaware heirs to run into difficulties because they do not realise the real consequences of failing to make a declaration on accepting or rejecting an inheritance. This problem has frequently been subject to court proceedings in an increasing number of cases[52].

Under the law in force until 17 October 2015, the only solution to partially limit the consequences of the legal fiction of a simple acceptance of inheritance stated in Article 1015 § 2 of the PCC in the old wording was to apply regulations concerning defects in the declaration of intent, which also apply to the declaration on the acceptance or rejection of inheritance, and also when there was no declaration within the foreseen deadline, or to apply regulations concerning the

[52] M. Pazdan, *Zmiany w ukształtowaniu zasad odpowiedzialności*, p. 432.



abuse of a subjective right, stated in Art. 5 of the PCC. The chances of the court applying both these solutions were slight.

This was an imperfection in the legal provisions in this field, which were removed by the amendment of 20 March 2015, and by introducing the rule of liability with the benefit of inventory in place of the hitherto binding rule of unlimited liability for inheritance debts. At the same time, the amendment introduced a new mechanism preventing negative consequences for inheritance creditors. These aims concerning reliable ascertainment of standing of the inheritance assets are fulfilled by the new institution of the private inventory list.

It remains to be seen whether the practice based on the amended law will show the direction of further legal changes[53]. Questions about the hierarchy of the repayment of debts[54] and the grounds for introducing a convocation procedure[55] remain unanswered. Nevertheless, the introduced amendment is a very important step forward in the development of the Polish law of succession.

[53] The scope of the amendment was limited; see G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców*, pp. 147–148.

[54] G. Gorczyński, *O ograniczonej odpowiedzialności spadkobierców*, pp. 153–154; P. Księżak, *Dobrodziejstwo inwentarza*, pp. 900–909.

[55] Demanded in the latest literature by E. Macierzyńska-Franaszczyk, *Odpowiedzialność za długi spadkowe*, p. 330; E. Skowrońska-Bocian, *Odpowiedzialność za długi spadkowe. Komentarz*, p. 71; P. Księżak, *Dobrodziejstwo inwentarza*, p. 876.

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# EVOLUTION OF PARENTAL RESPONSIBILITY (PARENTAL POWERS)[1]

## Parental responsibility in historical perspective

There were a different terminology in a different time periods for a summary of the obligations and rights of parental responsibility as we know it today (however, it should be pointed out that the different terminology was associated with differences in terms of content, that means in the obligations and rights).

Regarding the historical perspective, the "parental power" and "paternal power" used in the Common Civil Code[2] cannot be forgotten when analyzing the complex of obligations and rights emanating from the institute of parental responsibility. Common Civil Code of 1811, was based on the decisive position of the father in the family and in this context it regulates the institute of paternal power[3] (§ 147 CCC). These rights and obligations belonged only to the father. In the case that the father was not alive or known, these rights exercised the guardian. It was an authorization concerning decisions on the most relevant issues of the child, and management of the child's property (§ 149–151 CCC), representing a child (his father was the legal guardian of the child) and giving consent to the legal acts (§ 152–153 CCC), to establish the will or other disposition of property, or to exclude some people from the trusteeship (§ 196 CCC), to manage common household of spouses and children (§ 91 CCC), choice of career of the child (§ 148 CCC) and permission to marry (§ 49 CCC).



Except the paternal power the Common Civil Code established the obligation of both parents called the parental power (§ 139 CCC). It was a duty to raise the child, with the exception of the rights included in paternal power; it included additional rights and responsibilities that belonged to both parents. It was a duty to properly educate a child (§ 139 and 141 CCC), to control of the child (§ 144 CCC) to have the child with him/her and to discipline the child (§ 145 CCC). As it is clear from the above list, the general Civil Code integrated what we now understand as a parental responsibility under the paternal power (§ 147 CCC), and under the parental power (§ 139 CCC).

The next statute after the Common Civil Code, the Act on family law[4] from 1949, has pointed out the equal status of both parents in the relation to the child (§ 55 AFL) and regulate the rights and duties of parents to the child as a parental power (§ 52–62 AFL). Parental power was defined as a set of rights and duties of parents and the statute stated demonstrative list of its content in § 53 AFL. According to this provision parental power contained the rights and duties of parents to manage behavior of children, to represent children and to manage their assets. The role of guardian of the child comes into the consideration only in situations where a minor child had none of the parents with the parental power. Next statute, the Family Act[5] from 1963 did not take over the term "parental power", because the power and rights of parents result more from their social mission and the goal to educate their children, than from some superior position of parents based on the power of parents[6]. Instead the Family act regulated "parental rights and obligations". Which of the rights and obligations belong to parental rights and obligations and which of them exist outside of this framework was long debated question in litera-

[1] This article arose from the funds provided by the project IGA 2016/016.

[2] declared by patent from 1.6.1811, № 946 Call., hereinafter referred to as „CCC".

[3] See the commentary to § 147 et seq. in: F. Rouček, J. Sedláček a kol., *Komentář k Československému obecnému zákoníku občanskému a občanské právo platné na Slovensku a v Podkarpatské Rusi*, Reprint původního vydání, Praha 2002, p. 719 or E. Svoboda, *Rodinné právo Československé*, 1. vydání, Praha 1946, p. 69 or J. Krčmář, *Právo občanské IV. Právo rodinné*, 3. vydání, Praha 1936, p. 74.

[4] Act. № 265/1949 Call., hereinafter referred to as „AFL".

[5] Act. № 94/1963 Call., hereinafter referred to as „FA".

[6] See the explanatory memorandum to § 30 FA.

ture[7]. The Family Act in its original version contained a generally formulated focus of the child's upbringing.

The § 31 FA, which contained the provision of parental rights and obligations, was repealed by law № 91/1998 Coll. (so called Large amendment) as obsolete and it was replaced by a new text. Large amendment of the Family Act, has replaced the current term of parental rights and obligations by the concept of parental responsibility. The new term was more responsive to the modern concept of regulation of relations between parents and children contained in The Convention on the Rights of the Child (parental responsibility, art. 5 of the Convention) and it respected the legal status of the child in relation to his parents. The Family Act used the term "responsibility" taking into account the need to differentiate this term from the vindicatory concept of "liability" (e.g. for damages). Parental responsibility was defined as a set of rights and responsibilities in the care of a minor child, including in particular the care of his health, his physical, emotional, intellectual and moral development and right to represent the minor child and the administration of his assets.

In the exercise of parental responsibility, the parents were required to thoroughly protect the interests of the child, to control his conduct and perform the supervise corresponding to the stage of his development. Parents had the right to use adequate educational means, which would not affect the child's dignity and threaten the health, physical, emotional, intellectual and moral development (§ 31 FA after the large amendment).

The current family law is contained in the Civil Code[8]. The change of the rights and duties of parents to children in this act is not in the content, but in the wording. The new term is "parental liability". According to the explanatory memorandum to the Civil Code, what was concluded earlier by literature or case law to be the right or obligation of parents, is now expressly stated in the Civil Code[9].

[7] See Z. Češka, *Československé rodinné právo*, 1. vydání, Praha 1985, p. 164 and M. Hrušáková a kol., *Zákon o rodině. Zákon o registrovaném partnerství. Komentář*, Praha 2009, p. 127.

[8] Act № 89/2012 Coll., hereinafter referred to as „CC".

[9] See the explanatory memorandum to § 858 in K. Eliáš, a kol., *Nový občanský zákoník s aktualizovanou důvodovou zprávou a rejstříkem*, Ostarava 2012, p. 802.



## Parental liability nowadays

Currently, parental liability is defined by the Czech Civil Code. According to the provision of § 858 CC parental responsibility is defined as a set of obligations and rights of parents, which involve child care, including in particular the care of his health, his physical, emotional, intellectual and moral development and child protection, keeping personal contact with the child, securing his upbringing and education, determining the place of his residence, the representation and management of his assets. It is a set of obligations and rights, through which parents act on the child until the child is fully legally competent. It is a complex of obligations and rights, allowing parents to effectively carry out their duties and rights to the child[10].

Parental liability is a general name for a group of the obligations and rights of parents to children. Besides parental liability, there exists a complex of rights and duties of parents to children associated with the personality of the child and the rights and duties of a personal nature (§ 856 CC), and maintenance obligations of parents towards their children (§ 859 CC). Parental liability arises by birth of the child and ceases when the child reaches full legal capacity.

Parental liability exercise parents with the manner and to the extent which is appropriate for the child's development. All rights and obligations arising from their parental liability are long-term, they will not tire by one act of a parent. Parental liability is infinite and it is internally limited by the interest of the child. However, what is still in child's interest, and what is the damage is largely influenced by the mentality of society and the family in which the child lives (e.g. atheistic or religious family etc.). Regarding the concept of parental responsibility in the new Civil Code, it is a clear distinction between carrying parental responsibility and exercising parental responsibility. Obligations and rights arising from parental responsibility are established by the status based parent-child relationship, and thus are formed on the basis of factual circumstances. These parts of law are the most commonly

[10] For a number of legal rules regulating the rights and duties in the family is a characteristic the large influence of morality on the base of which was the text of several provisions of CC formed. Series of standards is so imperfect, thus lacking the penalty for violating them (e.g. § 883 CC "Parents and children are obliged to help each other, support each other and respect themselves for their dignity").

used in the everyday life, although many parents do not realize it at the moment (daily child care, personal contact with him, etc.). Parents shape the personality of the child through parental liability, as complex of responsibilities and rights of parents to the child[11]. As such, it has a major contribution to the further development of the child.

Parental liability is a summary of the rights and duties of parents towards the child. Where parents have a certain duty, a right of the child corresponds to this duty. Reciprocity of these relationships is unique and cannot be compared to the classic reciprocal relationship arising from the contractual relationship creditor – debtor. For example, in the case of right of a contact of one parent with minor child, you need to think about whether minor child also has an obligation to respect that right of parent, and therefore has an obligation to be in a contact with a parent. In some cases, it may be questionable whether a particular right correspond any obligation and, if so, whether this obligation can be enforced in some way, particularly in the form of state power (execution). Enforceability of the claim is in many cases impossible, because the court only declares the existence of certain obligations, but such a decision is just heavily enforceable by state power (perhaps in some cases by putting penalties).

Equal status of both parents, as we know it today, was not common in the past (see. e.g. institute of paternal power). Today the equal status of both parents in these rights and obligations towards the child is established in § 865 CC. However, it is necessary to consider whether this provision is always fulfilled, e.g. in society generally practiced tendency to entrust the child after the divorce of parents in the care of mothers rather than fathers.

Establishment of parental liability law connects with the birth of a child (§ 858 CC). In relation to the mother's parental liability arises at the time of birth. In the case of surrogacy, this situation is not explicitly addressed. Surrogate mother, who gives birth to a child, will have the parental liability, which subsequently ceases the same way as in the case of child's adoption. The parental liability arises to

[11] When applying standards concerning the duties and rights within the family it is also necessary to consider the influence of the very personality of parents, eventually children (child's best interests), which causes an exceptional individuality of these relationships in the legal system.



father simultaneously with the establishment of one of the presumptions of paternity when this moment may be the same as the mother's one (for the first presumption of paternity and the second presumption of paternity in the event that there is a consenting declaration of paternity before the child's birth or further when the man give his consent to the artificial insemination), respectively may follow in the period after birth (with the determination of his paternity on the basis of the second argument after the birth of a child, and under the third presumption of paternity). Then parental liability of adoptive parent arises when decisions on adoption becomes final, while parental liability at the same time terminates to the child's parents.

Extinction of parental liability is associated in most cases with a child reaching the age of majority, when the child acquires full legal capacity. The moment of reaching the majority of the child, the age of his 18 years, is the ultimate moment when parental liability to the child ceases. Even in the case when the child reach the majority, but he does not have full legal capacity, the parental liability is terminated and the guardian should be appointed to the child in parallel with the decision to limit his legal capacity.

Parental liability can terminate even before reaching the majority of the child and that by the decision on the adoption of a minor child, by marriage of minor, by the decision, which granted full legal capacity to a minor (§ 37 CC), by the decision to waive parental liability by the court (§ 871 CC) or by death (declaration of death) of the parent or the child. Restriction of parental liability (§ 870) terminates only the part of parental liability which is stated in the decision.

Regarding the problematic issues of parental responsibility, it should be noted that the rise of a number of issues is associated with the adoption of the rules contained in the "new" Civil Code. However, many questions remain from the previous time, e.g. the issue related to the representation and the child care in case of health care (the prohibition on providing health care to their child, which is in conflict with their religious beliefs), the question of the use of educational means (§ 884 CC) and educational measures (§ 857 paragraph. 2 CC) towards the child[12].

[12] These may be used by parents depending on the age and stage of intellectual development of the child. Determining the specific means remains at the discretion of parents.

Other problematic issue is e.g. § 868 paragraph. 2 CC, according to which the exercise of parental liability is suspended *ex lege* for a parent whose legal capacity was limited in this area – it means that when the parent is restricted in legal actions involving treatment with the value over 10.000,- CZK, the parent is limited in parental liability in managing financial resources of the child in the value over 10.000,- CZK, or the parent is restricted in parental liability in managing the property of the child as a whole?

The provision of § 868 paragraph. 2 CC further provides that the court may decide to maintain the performance of the duties and rights of custody and personal contact with the child. This raises the question whether the right to have contact with the child should be the part of parental liability. Even mentally ill parent who is limited in incapacitation should have *ex lege* right to have contact with his child, and the right should not be automatically limited by the loss of full legal capacity. In connection with this issue it is necessary to think about if the child has the right to have a contact with the parent, when the parent lose the right to have contact with the child.

Regarding the new legislation, there is not a consensus when it comes to the decisions on parental liability for a person who is not a parent yet. The express wording of § 865 paragraph 2 CC provides that "if the court decides to limit the legal capacity of parents the court decides together on their parental liability". Therefore, the decision on the legal capacity of a person who is a parent is mandatory. However, this procedure is not obligatory when court decides on the legal capacity of non-parent. It can be leaned toward the view that the court should rule on parental liability in this case as well, because especially for those living in a marriage can be assumed that a child can be born. The question is whether it is possible to restrict the legal capacity of the rights and obligations that do not yet exist.

The answer to the slice of the aforementioned problematic issues that come with the institution of parental liability will be left to the interpretation by the courts and the literature.

Protecting children against abuse provides the Convention on the Rights of the Child adopted by the United Nations in 1989.

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# AN INSIGHT INTO OPTIONS OF EXPRESSION OF WILL IN THE CASE OF DEATH[1]

## Introduction

Current Czech law of succession is built on the traditional rule of autonomy of will, which is the leading principle of entire private law. Law of succession enables for the decedent to make, in the case of death, some of institutions of inheritance law, which are inheritance contract, testament, or testamentary clause. Decedent has the option in the case of death to call heirs and legatees and to determine conditions, mandates and other clauses. At disposition *mortis causa* the decedent has many options how to express his own will, but he must respect some limitations, set by law of succession to protect the interests of heirs, forced heirs, or creditors. Should the decedent fail to respect the limitations set to the protection of such persons, the protected persons could asset their rights even against the will of the decedent. Law of succession balances the right of the decedent to make disposition of his property in the case of death, and the interest in the protection of rights of some other persons who have certain relations with the decedent and whose protection is desirable for the society. In addition to the protective provisions, the decedent has to meet often strict formal requirements applied to the particular dispositions *mortis causes*.

[1] The article is a partial output of the project IGA_PF_2016_009 „Autonomie vůle zůstavitele" –Univerzita Palackého v Olomouci, Právnická fakulta (Autonomy of will of decedent – Palacký University in Olomouc, Faculty of Law).

## Donation *mortis causa*[2]

The Civil Code regulates transition of property rights and duties in the case of death in the part on law of succession, but in the part concerning law of obligations it offers the decedent the institution of obligation rights, by which it is possible to evade most inconveniences and limitations connected to law of succession. Such an institution is donation *mortis causa*, which may be characterised most accurately by the definition of Roman Justinian law: Donation *mortis causa* is a donation when the donor would rather keep the thing than to give it to the donee, but still the donor prefers giving the thing to the donee to bequeathing it to his heirs[3].

The Civil Code regulates donation *mortis causa* in Sections 2063 and 2594 Subsection 2. Should donation *mortis causa* be valid, the law requires fulfilment of several conditions. First of all, the donation contract must comply with provisions of law of donation, and performance is postponed by suspensory condition, under which the donee survives the donor. Performance is understood as transfer of proprietary rights and often also handing over of the gift. Further, the donee must accept the gift and the donor must expressly waive the right to revoke the gift, and provide the done with an instrument containing a confirmation thereof. The donation contracts as such must be produced at least in a simple written form, as well as the deed on waiver of the right to revoke the gift, unless it is contained in the contract alone. Meeting those requirements is considered as donation *mortis causa*, based on which the donee acquires proprietary rights over the subject of donation as early as at the death of the donator (things registered in a public register, ownership of which is bound to registration, do not pass over by the death of the donor, but the donee, after the death of the donor, has the right to file a motion to register his proprietary rights to the thing in the register). If those requisites are

[2] See more e.g.: A. Talanda, *Donation "mortis causa" - trojský kůň dědického práva*, "Právní rozhledy" 2015, č. 13–14, p. 474–481; A. Talanda, *Donation "mortis causa"*, [in:] P. Salák, O. Horák, et al., *Law of Succession in the Middle-European Area*, Cracow 2015, p. 76–83; O. Horák, *Darování pro případ smrti a ochrana dědiců (k diskusi o novelizaci občanského zákoníku)*, "Právní rozhledy" 2014, č. 22, roč. 22, p. 783–785.

[3] Digesta 39, 6, 1, pr.



not met, the contact shall be considered as determination of legacy, establishing the right of obligation towards the heirs.

The regulation of donation *mortis causa* raise many problems in interpretation of law of succession. The crucial problem is first of all the fact that by the donation *mortis causa* it is possible to entirely evade provisions of law of succession. In such a case the decedent does not have to follow the strict and contextual requisites of disposition *mortis causa* under law of succession, and he therefore may evade also the limitations by law of succession, set to the protection of interests of certain persons, mainly those of the forced heirs. Donation *mortis causa* as such is an institution of law of obligations, on which the limitations of law of succession cannot be applied. There neither the right to forced share, rights of certain persons to maintenance, nor Falcidian Portion will be applied. Consequently, the exercise of donation *mortis causa* will lessen or exclude the possibility to claim heir's share, forced share or the right to maintenance, as the base for calculation of those claims is the whole decedent's estate. However, upon donation *mortis causa*, at the moment of fulfilment of the suspensory condition, i.e. the death of the donor, proprietary rights to the donated thing pass over to the donee (excluding the things registered in the public register), and the value of the decedent's estate shall be lessen by those things. At donation *mortis causa*, the protection provided by law of succession to creditors of the donor will not apply. At donation *mortis causa*, debts of the decedent (donor) are not transferred to the donee, the same way as the debts are not transferred to the donee at common donation.

At donation *mortis causa*, law primarily presumes assessing such a donation as a legacy, provided that not all requirements for donation *mortis causa* are met.The problem is that the law generally regulates the establishment of legacy in the part concerning law of succession, and certain formal requisites are required for the establishment thereof, which requisites usually will not be fulfilled at donation contract. A question may arise whether a new form of establishment of donation *mortis causa* is permitted in the form of donation contract, or if law implicitly requires fulfilment of formal requisites for the making of legacy even considering donation *mortis causa* as a legacy. The intention of the lawmaker is not clear, and we may imagine arguments for both variants. The first option, i.e. another form of legacy, is support-

ed by rule of autonomy of will and the rule of interpretation of conduct as valid rather than void, and the interpretation towards satisfaction of the acting person. The second option, i.e. the necessity to meet formal requisites of legacy, favours the requirement of interpretation of all provisions of law in mutual conformity, as related to undesirable evading of law of succession. Another controversial field is the question of obligatory waiver of the right to revoke the gift, which is a condition of validity of donation *mortis causa*. It is disputable if the waiver of the right to revoke the gift at donation *mortis causa* is at the same time definite waiver of the right to revoke the gift for any reason whatsoever, for which it is otherwise possible to revoke common donation (change of circumstances, need, ungratefulness), or if it is mere differentiation between donation *mortis causa* and legacy. From the nature of the issue donation *mortis causa* is one-sidely irrevocable, as it is a bilateral legal conduct, while establishing a legacy is by rule made by an unilateral, therefore freely revocable act.

We must not fail to notice, considering the current regulation of law of succession, that the institute of donation *mortis causa* is not necessary. The option to make disposition *mortis causa* by a bilateral legal act is currently provided by the regulation of inheritance contract, which the decedent can conclude with any person. Donation *mortis causa* as a self-standing institute nevertheless typically occurs in legal orders that do not know inheritance contract or reserve it only to specific persons. The current Czech legal regulation provides the decedent with wide options for disposition *mortis causa* by means of some institutions of law of succession, and therefore classifying the regulation of donation *mortis causa* into the Civil Code is non-conceptual. Inconsistency of this concept is ever more striking in relation with the expansion of the duty of heirs to pay for the debts of the decedent or with the protection of forced heir, which can be evaded by donation *mortis causa*, albeit completely legally.

## Approaches to donation *mortis causa*

Different legal orders have different approaches to donation subjected to the death of the donor; in general, there are four: a) explicit permission to donate in the case of death and legal regulation thereof, b) regulation of a "conflict rule" that determines how to assess donation conditioned by the death of the donor c) explicit prohibition to donate in the case of death and d) missing regulation of donation *mortis causa*.



**Regulation explicitly enabling donation mortis causa** is contained for example in Austrian law. The Austrian Civil Code provides regulation of donation *mortis causa* (*Schenkung auf den Todesfall*) as an independent institution in Sections 956 and 603[4]. Donation *mortis causa* in the Austrian regulation requires a donation contract with suspension condition of the death of the donor, in the form of notarial deed. Such a contract is primarily considered a legacy, but after fulfilment of all requirements it stands as an independent institution of donation *mortis causa*. For the donation to be valid, the donee must accept the gift and the donor must waive his right to revoke the gift, and to produce a respective deed in that sense for the donee. Waiver of the right to withdraw the gift then serves as a feature differentiating donation *mortis causa* from a legacy, and revocation for reasons given by law is possible. Simultaneously, donation *mortis causa* does not evade provisions of law of succession, since it cannot limit the forced share of forced heirs, because the donation is included in the base for calculation of the forced share, and furthermore it is possible to claim return of the gift in order to reduce the forced share. Further, according to Austrian regulations, it is not generally allowed to make an inheritance contract, reserved only to spouses or fiancés, and donation mortis only complements the regulation of law of succession.

An example of **regulation containing "conflict rule"**, under which a legal conduct leading to donation *mortis causa* is assessed, could be German law.[5]The German Civil Code regulates donation *mortis causa* (*Schenkungsversprechen von Todeswegen*) in Section 2301[6]. That provision does not admit donation *mortis causa* as an independent institution, but it only determines explanatory rule for the situation that somebody would enter a contract of donation *mortis causa*.

[4] For detailed information see e.g. M. Längle, *Schenkung auf den Todesfall*, Wien–Graz 2009, p. 176; M.E. Keinert, *Schenkung auf den Todesfall*, Wien 2015, p. 295.

[5] Similar regulation is set in Art. 245 section 2 of the Swiss OR-ZGB.

[6] See e.g. P. Bassenge et al., *Palandt. Bürgerliches Gesetzbuch. Kommentar. 71st edition*, Munich 2012, p. 3087; I. Fekete, M. Feketeová, *Darovanie pre prípad smrti – donatio "mortis causa"*. "Justičná revue" 2006, № 10, p. 1446–1453.

As a rule, donation *mortis causa* is assessed according to provisions in the case of death under law of succession, first of all by the provision on inheritance contract, which the decedent may enter with anyone under German law. If donation *mortis causa* is applied, but the particular gift has been handed over already during the life of the dotor, regulation on common donation will be applied to that legal conduct. The German regulation of the pledge of donation *mortis causa* prevents the possibility of evading provisions of inheritance law through donation.

**Explicit prohibition of donation *mortis causa*** is contained in the Slovak Civil Code, which was valid also in the territory of the Czech Republic until 2014. Provision of Section § 628 subsection 3 explicitly prohibits any donation, performance of which is to come into effect after the death of the donor. Regulation in this Code does not recognise any legacy and it considerably limits autonomy of will of the decedent.

**Regulation of donation *mortis causa* is completely missing** in the Polish Civil Code. However, in Polish legal theory and practice there were discussions about the possibility of such a donation. Article 941 stipulates that property in the case of death may be disposed of only by the means of testament. Article 1047 prohibits entering inheritance contracts from a living person. Both of the provisions imply impossibility of donation *mortis causa*. However, the Polish Supreme Court, in its judgment III CZP 79/13 of December 13, 2013, decided that disposition in the case of death only through testament (pursuant to art. 941 CC) does not apply to donation *mortis causa*, because that provision can only be applied to inheritance law due to its categorisation within that law. Further, no contradiction has been found either with art. 1047, if only precisely defined individual things are transferred by donation *mortis causa*. Therefore, donation *mortis causa* (*darowizna na wypadek* śmierci) is possible to apply in Poland.

## Conclusion

Donation *mortis causa* is a traditional institution that has been incorporated into the current Czech legislation with a good intention of return to traditions, though the positioning thereof is rather unlucky as concerns regulation of inheritance law. The regulation of donation *mortis causa* in the current Czech Civil Code faces many problems, out of which some have been outlined in this article. A short excursion to foreign legislations has shown that the solution of a situation where the performance of a donation contract is conditioned by the death of the donator may be varied, but the solution should first of all correspond with the conception of the inheritance law, and should complement it. It is therefore worthwhile to take under consideration the necessity and desirability of the institution of donation *mortis causa*, or to consider introduction of regulation that would be a "conflict rule" for the cases of donation conditioned by the death of the donor.

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# DEVELOPMENTS IN LEGAL INSTITUTIONS OF "HEIR WITH CAPACITY TO INHERIT"[1]

Succession is an inevitable part of the life of almost everyone, though it is subjected to the fulfilment of certain conditions without which the hereditary succession cannot take place. The precondition is the death of the decedent, the existence of decedent's estate and the existence of an heir. The person of the heir must be identified and capable. The subject is considered certain and identified once he or she is the beneficiary of one of the titles of inheritance (law, testament or inheritance contract). At the same time, this specific subject must be capable to inherit. Capacity to inherit can be divided into absolute and relative one[2]. While the absolute one is given in relation to all possible decedents (if the heir is the bearer of respective rights and duties[3]), relative capacity to inherit concerns inheritance from a particular person and it is completely dependent on behaviour of the potential heir towards the decedent. The potential heir may be deprived from this relative capacity to inherit if: he is incapable to inherit or is rightfully disqualified from inheritance by the decedent through disinheritance.

Capacity to inherit is also excluded in the case where the heir renounces inheritance by a contract with the decedent. After creation of succession right, the heir may decline or waive the inheritance.

[1] The article is a partial output of the project IGA_PF_2016_008 „Dědická způsobilost jako jeden z předpokladů dědické sukcese a její reflexe v řízení o pozůstalosti" - Palacký University in Olomouc, Faculty of Law.

[2] F. Rouček in: F. Rouček, J. Sedláček, *Komentář k československému obecnému zákoníku občanskému a občanské právo platné na Slovensku a v Podkarpatské Rusi*, Volume III, (§ 531–858), Praha 1935–1937, p. 30–31.

[3] Exception is an unborn child, so-called *nasciturus*, provided it is born alive.



However, in such cases incapacity to inherit is not considered in the strict sense of the term, since the heir is personally capable to inherit but he, in his own will, excludes himself from succession rights.

## Notion of "heir with capacity to inherit" in Roman law

The term "capacity to inherit" can be found as early as in Roman law. Capacity to inherit belonged to almost everyone[4], who was alive at the time of death of the decedent (so-called passive capacity to inherit)[5]. As to legal entities, capacity to inherit first of all belonged to state (later also communes), and further also to foundations that were often established right for the purpose of disposition in the case of death[6]. Many persons, though, were excluded form inheritance after a Roman citizen by law (typically slaves or foreigners, so-called *peregrini*)[7].

Further, passive capacity to inherit was not enjoyed by persons difficult to identify, so-called *personae incertae*. These were persons who the decedent indicated so unclearly that they could not be specified by decedent himself, for example: *"the one who will first to come to my funeral"*, *"the future husband of my daughter"*[8]. Notion of persons difficult to be identified also comprised the ones who belonged to the local community and who were distinctive by a common feature, e.g. the old, the poor or the ill[9].

The person had to have capacity to inherit both in the time when the person was called and in the time when the inheritance devolves upon him, up to the time of actual acquisition. The lack of capacity to inherit made the disposition mortis cause void, and called were

[4] I.e. natural person.

[5] Even an own slave, provided he was freed at the same time by the decedent.

[6] Private corporations were excluded from law of inheritance. J. Vančura, *Úvod do soukromého práva římského. Díl II*, Praha 1923, p. 432.

[7] Other persons who did not have absolute capacity to inherit were people sentenced to death (so-called capitedamnati), voluntary exiles, (aquae et ignisinterdicti), heretics, Christians who abandoned their religion (apostates), children of high treason convicts, widow who breached the mourning year, persons living in incest (in incestisnuptiis). J. Vančura, *Úvod do soukromého práva římského. Díl II*, Praha 1923, p. 432.

[8] J. Vančura, *Úvod do soukromého práva římského. Díl II*, Praha 1923, p. 442.

[9] P. Dostalík in: W. Dajczak, T. Giaro, F. Longchamps, *Právo římské. Základy soukromého práva*, Olomouc 2013, p. 64.

also those who would have been called if the disposition mortis cause had not been made.

Passive incapacity to inherit was different form the term **incapacitas**, which means "incompetence to acquire anything from inheritance". These persons met all other legal conditions for inheritance, but they had certain incapacity, predicted by the lawmaker, so-called "*capacias*", which had the consequence that at the called persons it caused invalidity of the acquisition, or made void what was already acquired. In this case, decisive was the time when the inheritance was actually acquired. The share of the person incompetent to acquire anything from inheritance was forfeited for the benefit of others or of the state.

The last legal institution connected to incapacity to inherit was **indignitas**, or unworthiness to be heir or to receive a legacy. So-called **Indignus** was everyone who has done a significant wrong to the decedent or against his last will. These cases were not exhaustively listed; generally they were cases where the person has done a severe wrongdoing against the decedent or his last will[10]. Inheritance of such an unworthy heir was taken away from him and it devolved on the State[11].

## General Civil Code

The General Civil Code regulated the capacity to inherit in Section 538 as follows: *Anyone who is eligible to acquire property is, as a general rule, capable to inherit.* Thus, heir could be every person, both legal and natural, who was the bearer of rights and duties[12]. Also, religious corporations as the Church, spiritual orders and congregations were in general capable to inherit[13].

[10] E.g. anyone who caused, albeit by negligence, the death of the decedent; further, the one who failed to buy the decedent back from slavery, abandoned him in mental disease, the one who failed to pursue a murderer, the one who violently made the testator to make, alter or revoke the last will, whoever attempted to make revocation thereof, etc.

[11] J. Vančura, *Úvod do soukromého práva římského. Díl II*, Praha 1923, p. 444.

[12] Under Section 544 the national who left the country or military service without due permission could have been deprived of absolute capacity to inherit. This provision became void, effective from November 4, 1918. Also, under Section 539 it could be excluded for religious orders and their members (e.g. the person made the vow of poverty). See page 37 Rouček and Sedláček.

[13] Capability could be excluded at religious orders or their members (e.g. based on the solemn vow of poverty). F. Rouček in: F. Rouček, J. Sedláček, *Komentář k československému obecnému zákoníku občanskému a občanské právo platné na Slovensku a v Podkarpatské Rusi*, Volume III, (§ 531–858), Praha 1935–1937, p. 33–38.

[14] V. Knapp, *O vydědění a o tzv. negativní závěti. Socialistická zákonnost*, 1983, № 6. p. 327.

[15] Even though such behaviour when the testator forgave his descendant and disinherited him anyway, or did not destroy the deed of disinheritance after such forgiveness, is to be considered as acting against good morals.



Further, General Civil Code regulated legal institutions which ruled over the above-mentioned relative capacity to inherit, i.e. capacity to inherit from particular persons. Thus, the following persons were excluded from the right to inherit from a particular decedent, once the person:

- renounced succession rights through a contract with decedent, or
- was excluded by decedent in the form of disinheritance
- was incapable to inherit (indignity).

Incapacity to inherit was regulated in Sections § 540–543 and exhaustively stated the reasons by fulfilling of which the person became incapable to inherit by law, therefore it was not necessary to act anyhow on the side of the decedent. Concerned was a criminal act against the decedent as well as a contemptible conduct against the decedent's last will (Section 542). The reason for incapability to inherit was also adultery and incest (Section 543), for validity of which, however, a court confession or conviction was required. The only option to exclude incapability to inherit was forgiving of the act by the decedent.

Apart from incapacity to inherit, the General Civil Code stated that disinheritance requires an active legal act by the decedent, for the reason that conducts for which it is possible to disinherit do not reach the intensity sufficient for exclusion from the right of succession[14]. Yet, the Code stated that mere forgiveness is not satisfactory for extinction thereof[15], as it is at incapacity to inherit, but the deeds containing the statement of disinheritance must be destroyed. In Sections 768–773, the General Civil Code established four comprehensive reasons for disinheritance, which were, in various forms, adopted by the following civil codes. The decedent could either disinherit a heir who failed to provide him with necessary assistance at a time of need in destitution, should he has been sentenced to life imprisonment or twenty years imprisonment for criminal offence, or if he per-

manently lead life inconsistent with public morals, or if he was indebted or prodigal(in such a case his forced share had to be conferred to his children)[16]. Yet, disinheritance was also possible to apply for reasons establishing incapability to inherit[17].

The regulation contained in the General Civil Code was inspiration both for bills of civil codes in 1931 and 1937, and for the regulation in the current Civil Code. In this sense, completely different was the regulation of 1950 and 1964, which is discussed herein below.

## Capacity to inherit in Civil Code of 1950

The Civil Code of 1950 was created in the time of huge political changes, so its contents reflect the changes. The wording of the Civil Code was intended to be simplified as much as possible so that lay public could comprehend. For those reasons text of the Code was shortened to only 570 sections. Many institutes of law of inheritance were removed (e.g. donation *mortis causa*, some forms of testament or unlimited liability for debts of the decedent). The leading rule of inheritance law was preference of intestate succession to testamentary succession[18].

Pursuant to Section 510, heir could be both natural person and legal entity. Such a person had to exist at the time of death of the decedent (with the exception of *nasciturus*), therefore the decedent could not designate as heir the foundation that was only established by the testament. Under the provisions of the Code, forced heirs were descendants, parents and grandparents. Capacity to inherit could be excluded, the same way as in the General Civil Code, by renunciation of succession right, incapacity to inherit or by disinheritance. Incapability to inherit was a consequence of two acts – deliberate offence against the decedent (or close persons thereof) and/or contemptible behaviour against the last will of the decedent. Disinheritance of a forced heir was possible only when the disinherited person has left the decedent in destitution, has been convicted of a deliberate criminal offence, or permanently refused to work. If a descendant of the decedent was disinherited this way, his forced share was acquired by his descendants. The disinheritance had to fulfil the same formalities as last will. Disinheritance was not permissible for reasons giving grounds for incapacity to inherit so as these two institutions did not merge.

[16] General Civil Code in Section 769 regulated also the option to disinherit parents, for they were also included in forced heirs. Parents could be disinherited for the same reasons as descendants and additionally in the case that they neglected upbringing of the decedent.

[17] Pursuant to the original wording of the General Civil Code, the reason for inheritance was also "apostasy from Christianity ". This ground of disinheritance was abolished by Article VII of Act of May 25, 1868, № 49 ř.z.

[18] Intestate succession is strengthening of the family ties as the basis of development of the nation. Explanatory memorandum (Důvodová zpráva) p. 329; P. Bílek, M. Šešina, *Dědické právo v předpisech let 1925–2001. Zákony s poznámkami*, 1st edition, Praha 2001, p. 5.



## Disinheritance in Civil Code of 1964

The Civil Code of 1964 ideologically built on the Civil Code of 1950 and incapacity to inherit was established as the main reason for withdrawal of relative capacity to inherit. Under Section 469 incapacity to inherit occurred in the case that the heir committed a deliberate criminal offence against the decedent or his close persons, or contemptible conduct against provisions of the last will. The legal institution of disinheritance as such was not amended from coming into effect to the year of 1983. However, in the society still remained ideas on the need and moral justification of that institute, therefore the institute of disinheritance was re-introduced by Amendment of Act № 131/1982 Sb. Descendant of the decedent could, from this amendment up to 1991, be disinherited for only one reason: *failure to provide assistance for the decedent in his old age, sickness or other similar cases, contrary to the rules of socialistic coexistence.* Act № 509/1991 Sb. extended the grounds for disinheritance when the decedent could disinherit his descendant if: *in contradiction to good morals, he failed to provide to the decedent needed assistance in disease, old age, and other similar serious cases. He permanently fails to show true interest as he should as a descendant, He has been sentenced for deliberate criminal offence to at least one year imprisonment, He permanently leads unrestrained life.*

Disinheritance on the grounds establishing incapacity to inherit was not permissible, for the reason that the two institutes, i.e. disin-

heritance and incapacity to inherit, should not merge[19]. The option to renounce inheritance through a contract with decedent was not regulated by the Code.

## Disinheritance in Civil Code of 2012

The current regulation follows the regulation embodied in the General Civil Code and legislative proposals of 1931 and 1937. Capacity to inherit may be withdrawn for the reason of incapacity to inherit and disinheritance, at the same time returns to the code legal institution of renunciation of succession rights, by means of a contract with the decedent. The heir may waive his succession rights in favour of another heir or refuse them.

The new regulation of disinheritance restores many provisions and it is impossible not to see in the new regulation almost versatile transcription of provisions from the General Civil Code of 1937. Primarily, the reasons for disinheritance were extended by prodigal descendant, and disinheritance may also be applied on the grounds that establish incapacity to inherit.

## Conclusion

It is evident from the article that capacity to inherit is traditionally one of the basic preconditions of succession. However, in the course of time the content of capacity to inherit has changed in compliance with development of the society and its values.

[19] K. Eliáš et al., *Občanský zákoník. Velký akademický komentář*, 1st Volume, § 1–487, Praha 2008, p. 1178.

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# SPECIAL CONFLICT OF LAWS RULES FOR CERTAIN SPECIFIC TYPES OF CONTRACTS IN EUROPE (under the Rome I Regulation and Ukrainian Private International Law Act)

## Introduction for the beginning: the adoption and universal application of the Rome I Regulation

The Rome I Regulation[1] was adopted by the European Parliament and the Council of the EU on 17 June 2008. The new Rome I Regulation is a conversion of the Rome Convention on the law applicable to contractual obligations of 1980 (Rome Convention)[2]. The conversion of the Rome Convention into EU Regulation had been prepared by a Green Paper of 2003 on the conversion of the Rome Convention of 1980 on the law applicable to contractual obligations into a Community instrument and its modernisation[3] and by a Proposal of the European Commission in 2005[4].

[1] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) // Official Journal of the European Union. L 177 du 4.7.2008, pp. 6–16.

[2] Convention on the law applicable to contractual obligations opened for signature in Rome on 19 June 1980 (80/934/EEC) // Official Journal of the European Union. L 266 du 9.10.1980, p. 1–19.

[3] Green Paper on the conversion of the Rome Convention of 1980 on the law applicable to contractual obligations into a Community instrument and its modernisation (presented by the Commission). Brussels du 14.1.2003, COM (2002) 654 final.

[4] Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I) presented by the Commission. Brussels du 15.12.2005, COM(2005) 650 final, p. 5.

As we know, conflict-of-laws is a system of procedural rules which determine which legal system, and the law of which jurisdiction, applies to a given dispute. The rules typically apply when a legal dispute has a '*foreign*' element such as a contract agreed by parties located in different countries, although the '*foreign*' element also exists in multi-jurisdictional countries[5]. And the Rome I Regulation is the special conflict-of-laws instrument concerning the applicable law to contractual obligations with the '*foreign*' element.

The conversion of the Rome Convention into Regulation entails some obvious practical advantages. The Rome I Regulation has been entered into force on the date of 24 July 2008[6] and has become applicable to the contracts concluded after the 17 December 2009[7].

The scope of application of the Rome I Regulation is unchanged. Like the Rome Convention, the Rome I Regulation is applicable even in the absence of reciprocity and if it leads to the application of the law of a third State (art. 2). The art. 2 of the Rome I Regulation follows the next: "*Any law specified by this Regulation shall be applied whether or not it is the law of a Member State*".

Universal application has the obvious merit of avoiding the coexistence of two different sets of applicable conflict-of-laws rules, respectively, in purely '*intra-European*' situations and in relation to third State. From that point of view of nation courts and lawyers, this is an important simplification.

## Material scope of the Rome I Regulation

On the one hand, Rome I Regulation applies to all contractual obligations in civil and commercial matters, as long as they involve a conflict-of-laws[8]. The requirement of involving a conflict-of-laws is meant

[5] J. Pazdan, *Rozporządzenie Rzym I - nowa kolizyjnoprawna regulacja zobowiązań umownych*, [in:] *Problemy prawa prywatnego międzynarodowego*, T. 5, 2009, pp. 9–10.

[6] According to Art. 29, the Rome I Regulation entered into force on the 20th day following its publication in the Official Journal of the European Union, i.e., on 24 July 2008.

[7] Art. 28 of the Rome I Regulation: "Application in time: This Regulation shall apply to contracts concluded after 17 December 2009".

[8] Art. 1(1) of the Rome I Regulation: "This Regulation shall apply, in situations involving a conflict of laws, to contractual obligations in civil and commercial matters".



to restrict the applicability of the Regulation to situations linked to at least two different countries. The official version of Rome I Regulation, in German language[9], avoids the wording '*in situations involving a conflict of laws*' and instead reads '*featuring a connection to the law of different countries*'. To clarify, art. 1(1) states that the Regulation '*shall not apply, in particular, to revenue, customs or administrative matters*' which matters are regularly considered not to affiliate to civil or commercial law but instead to public law.

On the other hand, Art. 1(2) excludes a number of obligations, which in substance are part of civil or commercial law but for different reasons shall not be treated under the Rome I Regulation: According to the art. 1(2) of the Rome I Regulation: "*the following shall be excluded from the scope of this Regulation:*

*(a) questions involving the status or legal capacity of natural persons, without prejudice to Article 13;*

*(b) obligations arising out of family relationships and relationships deemed by the law applicable to such relationships to have comparable effects, including maintenance obligations;*

*(c) obligations arising out of matrimonial property regimes, property regimes of relationships deemed by the law applicable to such relationships to have comparable effects to marriage, and wills and succession;*

*(d) obligations arising under bills of exchange, cheques and promissory notes and other negotiable instruments to the extent that the obligations under such other negotiable instruments arise out of their negotiable character;*

*(e) arbitration agreements and agreements on the choice of court;*

*(f) questions governed by the law of companies and other bodies, corporate or unincorporated, such as the creation, by registration or otherwise, legal capacity, internal organisation or winding-up of companies and other bodies, corporate or unincorporated, and the personal liability of officers and members as such for the obligations of the company or body;*

[9] As to the official languages of the European Union see Regulation № 1 Determining the languages to be used by the European Economic Community 1958 O.J. (17) 385 (stating the official languages of the European Union).

(g) *the question whether an agent is able to bind a principal, or an organ to bind a company or other body corporate or unincorporated, in relation to a third party;*
(h) *the constitution of trusts and the relationship between settlors, trustees and beneficiaries;*
(i) *obligations arising out of dealings prior to the conclusion of a contract;*
(j) *insurance contracts arising out of operations carried out by organisations other than undertakings referred to in Article 2 of Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002*[10] *concerning life assurance the object of which is to provide benefits for employed or self-employed persons belonging to an undertaking or group of undertakings, or to a trade or group of trades, in the event of death or survival or of discontinuance or curtailment of activity, or of sickness related to work or accidents at work".*

## Party autonomy: the fundamental principle in European private contract law

Party autonomy has been and will remain the fundamental principle in European private international law in matters of contractual obligations. The freedom of choice of the applicable law by the parties, which was one of the cornerstones of the Rome Convention, has been reaffirmed in the Rome I Regulation. The parties also continue to be allowed to choose the law applicable to only a part of their contract (*dépeçage*)[11]. No departure from the Rome Convention has been intended in these respects.

To say clearly, the parties to the contract have the right:
- to chose the law of the State even if their relationship has no other objective connection with that State;

[10] Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance // Official Journal of the European Communities. L 345/11 du 19.12.2002.

[11] Recital (11) of the Rome I Regulation: "The parties' freedom to choose the applicable law should be one of the cornerstones of the system of conflict-of-laws rules in matters of contractual obligations".



- to 'split' the contract by making a partial choice of law;
- to conclude a choice-of-law agreement at any time, i.e., before or even after the conclusion of their contract.

As for the admissibility of the choice of non-State law, the Rome I Regulation takes rather conservative approach. Reverse to the Commission's Proposal, which allowed the choice of '*the principles and rules of the substantive law of contract recognised internationally or in the Community*'[12], the text of art. 3 refers to the 'law chosen by the parties', so the choice of such '*rules of law*' not belonging to a national system. The art. 3(1) of the Rome I Regulation precisely reads: "*A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract*".

This approach is implicitly confirmed by recital (13) of the preamble to the Rome I Regulation, where it is affirmed: "*This Regulation does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention*".

So, like the Rome Convention, Rome I Regulation does not allow the contracting parties to choose anything but national law. Therefore, non-State rules of law – such as *lex mercatoria*[13], the Principles of European Contract Law[14], or the UNIDROIT Principles of International Commercial Contracts[15] – cannot be chosen as the law applicable to the contract[16]. This intentional omission has been criticized as being out-of-touch with international commercial reality, contradictory to the principle of party autonomy and inconsistent with the arbitration laws of many countries. However, Rome I Regulation does

[12] See note 5, art. 3(2).

[13] *Lex mercatoria* relates to usages developed in international trade and general principles of law (the author).

[14] The Principles of European Contract Law, prepared by the Commission on European Contract Law (Ole Lando Principles). – Parts I, II and III. – 2003.

[15] International Institute for the Unification of Private Law (UNIDROIT), UNIDROIT Principles of International Commercial Contracts. – 2004.

[16] The Commission initially proposed to allow parties to choose non-State rules of law as the law applicable to their contract, including such rules as the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law, but excluding the *lex mercatoria*, which, according to the Commission, "is not precise enough" (see note 5, supra 5, 14).

not preclude the contracting parties from incorporating by reference into their contract non-State rules.

In the system of the Rome Convention, freedom of choice – although very broad – is subject to some restrictions in order to prevent derogation from mandatory rules. Most of these restrictions have been retained in the Regulation, although with some more or less important modifications.

The first restriction results from the art. 3(3) and applies to purely '*internal contracts*'. With respect to these contracts, the parties' choice is possible, but it cannot prevent the application of the mandatory provisions of the State where '*all other elements relevant to the situation*' are located.

Nevertheless, when the situation presents some international elements, the freedom of choice is only subject to the general restrictions of art. 9 and art, 21 of the Rome I Regulation, i.e., to the application of '*overriding mandatory provisions*' of the forum State or of a third State, and to the public policy exception. Also, special restrictions apply to consumer contracts, employment contracts; the choice of law cannot deprive the weaker party of the protection that is granted to such party by the mandatory rules of the law that would be applicable in the absence of a choice (art. 6 and 8 of the Rome I Regulation).

Thus, such limitations have proved to be insufficient to guarantee the application of the mandatory provisions of EU law, in particular of rules included in harmonization directives, because if the contractual obligation is international one, the parties to the contract can choose the applicable law without the restrictions of art. 3(3), even if situation is exclusively connected with two or more EU Member States. In such situations, to assure a more efficient protection of the minimum standard of EU law, the Rome I Regulation takes up a proposal of European Group of Private International Law[17] and includes in art. 3 a new para. 4, which is following the next: "*Where all other elements relevant to the situation at the time of the choice are located in one or more Member States, the parties' choice of applicable law other*

[17] European Group of Private International Law, 'Second consolidated version of a proposal to amend Art. 1, 3, 4, 5, 6, 7 and 9 of the Rome Convention of 19 June 1980 on the law applicable to contractual obligations, and Art. 15 of the Regulation 44/2001/EC (Brussels I)' (2002), para. III.



*than that of a Member State shall not prejudice the application of provisions of Community law, where appropriate as implemented in the Member State of the forum, which cannot be derogated from by agreement*".

This solution is reasonable, because it takes into account the special features of EU law as '*supranational*' system of law, whose rules are directly applicable in the Member States.

According to the Ukrainian PIL Act the principle of the party autonomy we can find in the art. 5 which states, that the members of the relationships may independently make the choice of the law applicable to their relations. In fact, Ukrainian PIL Act actually reflects the provisions of the Rome I Regulation.

## Applicable law in the absence of choice

The law applicable in the absence of choice to contractual obligations is governed now in EU Member States by art. 4 of the Rome I Regulation and in Ukraine by Articles 32(2), 32(3), 44 of the Law of Ukraine on Private International Law which was adopted in 2005 (Ukrainian PIL Act)[18] accordingly.

Where there is an absence of choice or failure to reach agreement, Rome I Regulation is intended to provide clear rules to determine the law that should be applied to the contract, while continuing to provide the courts with flexibility and discretion where it is apparent that the contract should be governed by the law of a different country.

Thus, the Rome I Regulation as the main normative act in the scope of contractual obligations and conflict-of-laws, provides rules to determine, within the EU, which law applies to contracts that have connections with more than one country, such as cross-border business or consumer contracts. This intention is for making clarity when the parties have not chosen the applicable law to regulate the contract[19].

[18] Закон України «Про міжнародне приватне право» [Zakon Ukrainy "Pro mizhnarodne pryvatne pravo] / Верховна Рада України [Verkhovna Rada Ukrainy]; 23.06.2005 № 2709-IV. Retrieved January 24, 2016 from: http://zakon5.rada.gov.ua/laws/anot/en/2709-15.

[19] A. Diamond, *Harmonization of Private International Law Relating to Contractual Obligations*, [in:] *Collected Courses of the Hague Academy of International Law*, Vol. 199, p. 273.

The new regulation act in EU as a Rome I Regulation is a welcome update of the choice-of-laws rules that were written in Rome Convention. In Ukraine the problem in the scope of contractual obligations where one of the parties to the contract has "foreign" element is pending. That's why we have to solve this question and such regulation like Rome I Regulation will help us to make it in life[20].

The determination of the law applicable in the absence of choice to the contract is one of the basement clauses dealt with by the Rome I Regulation. The mechanism provided for by the Rome Convention is based on the interaction between the general principle of proximity or the closest connection and the presumptive concretization of that proximity through the concept of characteristic performance. These two main provisions have been abandoned in the text of Rome I Regulation and replaced by a catalogue of conflict-of-laws rules for various categories of contracts based on rigid connecting factors[21].

The new provisions concerning the law applicable to contracts in the absence of choice is situated in Rome I Regulation as a contractual typology[22]. The point of departure of the new rule is not the general principle of the closest connection but a catalogue of eight types of contracts laying down the applicable law for each of them. The art. 4(1) of Rome I Regulation provides the next provision: "*To the extent that the law applicable to the contract has not been chosen in accordance with Article 3 (freedom of choice) and without prejudice to Articles 5 to 8 of the Regulation (contracts of carriage, consumer contracts, insurance contracts and individual employment contracts) the law governing the contract shall be determined as follows*:

*(a) a contract for the sale of goods shall be governed by the law of the country where the seller has his habitual residence;*

[20] B. Yuksel, *The Relevance of the Rome I Regulation to International Commercial Arbitration in the European Union, Journal of Private International Law*, Vol. 7, № 1, 2011, pp. 149–152.

[21] A. Bonomi, *The Rome I Regulation on the law applicable to contractual obligations: some general remarks*, [in:] *Yearbook of Private International Law*, Volume X (2008), Edited by P. Šarčević, A. Bonomi, P. Volken, European law publishers GmbH, Munich, and Swiss Institute of Comparative Law, 2009 (XVI), pp. 166, 173.

[22] M. Bogdan, *The Rome I Regulation on the law applicable to contractual obligations and the choice of law by the parties*, [in:] *Nederlands Internationaal Privaatrecht (NIPR)*, 2009, pp. 407–408.



*(b) a contract for the provision of services shall be governed by the law of the country where the service provider has his habitual residence;*

*(c) a contract relating to a right in rem in immovable property or to a tenancy of immovable property shall be governed by the law of the country where the property is situated;*

*(d) notwithstanding point (c), a tenancy of immovable property concluded for temporary private use for a period of no more than six consecutive months shall be governed by the law of the country where the landlord has his habitual residence, provided that the tenant is a natural person and has his habitual residence in the same country;*

*(e) a franchise contract shall be governed by the law of the country where the franchisee has his habitual residence;*

*(f) a distribution contract shall be governed by the law of the country where the distributor has his habitual residence;*

*(g) a contract for the sale of goods by auction shall be governed by the law of the country where the auction takes place, if such a place can be determined;*

*(h) a contract concluded within a multilateral system which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments, as defined by Article 4(1), point (17) of Directive 2004/39/EC, in accordance with non-discretionary rules and governed by a single law, shall be governed by that law*".

As we can see, in art. 4(1) the Rome I Regulation determines which law applies if there is no agreement between the parties. While inspired by the general objective of the Regulation – legal certainty, the default provisions vary depending on characteristics of the parties or on the object of transaction. A contract for the sale of goods and the contract for provision of services are governed by the law of the country where the seller or the service provider has his or her habitual residence (*lex firmae habitationis*).

In Ukraine the characteristic performance of the contract for the sale of goods and the contract for the provision of services is required only to seller or to service provider in accordance with art. 32 of Ukrainian PIL Act. These provisions for the first sight have some distinctions, but they have only verbal differences and not in essence.

In art. 4(2) Rome I Regulation provides that where the contract is not covered or the elements of the contract would be covered by more than one of points in the art. 4(1), the contract shall be governed by the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence. But the problem of this provision is the next: art. 4(2) of Rome I Regulation doesn't provide any indications on how to establish what party is to effect the characteristic performance of a given contract. This entails answers to two questions in a specific case before the court: which party effects the characteristic performance and where the habitual residence of that party is. The determination of the applicable law under art. 4(2) of Rome I Regulation is not depending upon the place of characteristic performance that may be more difficult to establish.

As for Ukrainian PIL Act, art. 32(2) has almost the same provision as the Rome I Regulation: "*The law applicable in the absence of choice to the contract is the law of the country with which the contract is most closely connected*".

The next paragraph of this article provides that the contract is most closely connected with the law of the country where the party to the contract required to effect the characteristic performance, which has a crucial importance for a contract, has his habitual residence.

We should admit that Ukrainian PIL Act has no a significant clear provision, which in our opinion, should be added into Ukrainian PIL Act for harmonizing it to EU conflict-of-laws rules in the scope of contractual obligations as it appears in art. 4(3) of the Rome I Regulation to make the applicable law to the contracts in the absence of choice more precise: "*Where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in Articles 4(1), 4(2) of the Rome I Regulation, the law of that other country shall apply*".

Also, art. 4(4) of the Rome I Regulation reads as follows: "*Where the law applicable cannot be determined pursuant to Articles 4(1), 4(2) of the Rome I Regulation, the contract shall be governed by the law of the country with which it is most closely connected*".

This last provision is one of the clauses which Ukrainian PIL Act is devoid. It is no significant because the art. 32(3) of Ukrainian PIL Act has the approximate meaning, but to create our national legal acts more clear and precise even in verbal sense or to help our litigation



to avoid misunderstanding we propose to add the same provision as an art. 32(4) of Ukrainian PIL Act.

## A view on the special provisions for the several types of contracts in Europe

Some special provisions Rome I Regulation have for the several types of contracts (contracts of carriage, consumer contracts, insurance contracts and individual employment contracts).

### Contracts of carriage

According to the art. 5 (1, 2) of the Rome I Regulation, contracts of carriage are divided into two types of transportation (carriage of goods, and carriage of passengers): "*To the extent that the law applicable to a contract for the carriage of goods has not been chosen in accordance with Article 3, the law applicable shall be the law of the country of habitual residence of the carrier, provided that the place of receipt or the place of delivery or the habitual residence of the consignor is also situated in that country (1). To the extent that the law applicable to a contract for the carriage of passengers has not been chosen by the parties in accordance with the second subparagraph, the law applicable shall be the law of the country where the passenger has his habitual residence, provided that either the place of departure or the place of destination is situated in that country (2)*"[23].

In Ukrainian PIL Act there are no special rules for contracts of carriage.

### Consumer contracts

Regarding the provision on consumer contracts, the Regulation retains[24]: (a) its universal scope of application, i.e., the rule offers a conflict-of-laws protection to both EU and non-EU consumers, irrespective of their place of habitual residence; (b) and the '*principle of most favourable law*', i.e., a choice of law in a consumer contract is valid

[23] Art. 5 of the Rome I Regulation.
[24] Art. 6 of the Rome I Regulation.

but it cannot deprive the consumer of the protection afforded to him by the law applicable by default. The Regulation extends the material scope of application of the rule and clarifies the definition of '*passive consumer*'. These new elements are taken from art. 15 of the Brussels I Regulation[25]. The art. 45 of Ukrainian PIL Act has some special conflict of laws provisions concerning consumer contracts, which are very similar to those we can find in Rome I Regulation.

### Insurance contracts

For reinsurance contracts, and for insurance contracts covering mass risks located in third countries, the general regime of the Rome I Regulation applies, i.e., art. 3, art. 4, art. 7(1). For insurance contracts covering large risks, regardless of where the risk is located, the law applicable shall be the law chosen by the parties in accordance with art. 3 of the Rome I Regulation. If the parties have not chosen any law, the contract shall be governed by the law of the country where the insurer has his habitual residence[26]. The provision also includes an escape clause: where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with another country, the law of that other country shall apply. For the definition of large risks, Rome I Regulation refers to art. 5(d) of the Directive 73/239/EEC[27]. In Ukrainian PIL Act there are no special rules for insurance contracts.

### Individual employment contracts

For labour contracts the parties can choose the applicable law according to art. 3 of the Rome I Regulation. However, the application of the chosen law cannot have the result of depriving the employee of the protection afforded to him by the mandatory rules of the law

[25] Regulation (EC) № 44/2001 of the Council of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I) // Official Journal of European Union. L 12/1 du 16.1.2001.

[26] Art. 7(2) of the Rome I Regulation.

[27] First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance // Official Journal of the European Communities. L 228 du 16.8.1973. Pp. 3–19.



applicable by default, i.e., in the absence of choice. In that case special provisions are provided in art. 8 of the Rome I Regulation, concerning the principle of characteristic performance and closest connection[28]. In Ukrainian PIL Act there are special provisions in art. 52, 53 and 54, concerning not employment contracts, but labour relations.

## Conclusion

The applicable law to the contractual obligations is governed in EU by the Rome I Regulations. The Ukrainian PIL Act hasn't got many distinctions of it, but has continually modernize itself, absorbing the best in the world approaches, including the EU legal experience.

[28] See art. 8 of the Rome I Regulation.

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# FROM ATTRIBUTION TO WRONGFUL ACT: FEW WORDS ABOUT CAUSATION IN INTERNATIONAL INVESTMENT ARBITRATION PROCEEDINGS

B.N. Cardozo in his book "The Paradoxes of Legal Science", when writing about legal truth noted that what is the main base of explanation depends on what is to be explained, and to some extent on the aim or interests of the person demanding the explanation[1]. The reason of starting this essay with those words is to show from the beginning how institution of causation is functioning in international law and in international investment arbitration practice.

In order to find state liable, few variables must be present: a) the state must perform some damaging activity which can be attributable to it; b) a causal link between the activity and damage must be established; c) violation of international law must be present, in other words a wrongful act must occur. This essay will only consider question of establishing causation link between a) and c) and furthermore the consequences of the presence of that link.

Nowadays there is a big terminological confusion surrounding the institution of causation. Some authors are very pessimistic and even say that "causation is at the vanishing point of the literature on State responsibility"[2]. These words might be justified in scope of scholar

[1] B.N. Cardozo, *The Paradoxes of Legal Science*, New Jersey: Lawbook Exchange 2000, p. 83–85.

[2] V. Tumonis, *The Complications of Conciliatory Judicial Reasoning: Causation Standards and Underlying Policies of State Responsibility*, HeinOnline, 11 Baltic Y.B. Int'l L. 135 2011, p. 137.



works, but the practice is showing how crucial and unavoidable the institute of causation is.

Causation in international law was developed largely by taking analogies from domestic laws with some adjustments required by the very meaning of international law. In order to give a thorough presentation of the topic, author of this work will give a brief explanation of the most important causation theories which are used by the investment tribunals.

The oldest of the approaches to the causation is so called direct causation. The most famous case in which it was use in arbitral proceedings is *Alabama Arbitration* from year 1872. In preliminary decision, Alabama Tribunal simply excluded some losses from its consideration, because they were far too indirect in relation to the actions taken. Arbitrators stated that indirect losses "do not constitute, upon the principles of international law applicable to such cases, good foundation for award of compensation or computation of damages between nations"[3]. From the beginning that standard was not widely accepted and replaced by the proximate causation standard. Direct causation to be fulfilled requires presence of a clear and not broken link between the wrongful act and the damage caused by it. It is irrelevant whether parallel or concurrent interruptions contributed to the damage. To say in plane words all what matters here is if act was an effective cause of damages. Problem with the direct causation is that it excludes possibility of demanding indirect loses e.g. *lucrum cessans*.

The most popular theory concerning causation is a proximate cause standard. In literature that concept is defined as "the duty to make reparation which extends only to those damages which are legally regarded as the consequences of an unlawful act. These are damages which would normally flow from such an act, or which a reasonable man in the position of the wrongdoer at the time of doing would have foreseen as likely to result, as well as all intended damages"[4]. This definition is showing all parts of the proximate causation: 1) the result of the existence of a natural chain between the wrongful act and the

[3] J.B. Moore, *History and Digest of the International Arbitrations to which the United States have been a Party*, 1928, p. 646.

[4] B. Cheng, *General...*, p. 253.

damage; 2) foreseeability, which is understood as the amount of precaution taken by the state.

First point means that the elements of the proximate causation consist of the existence of a natural or normal sequence between a wrongful act and a damage. The issue here is in what way can one determine natural after-effects. Answer to this question was given in several cases, one of which is *The Life Insurance Claims* case, where the US-German Claims Commission had to decide whether Germany had to pay damages to US insurance companies which suffered losses because of acceleration of the maturity of insurance contracts as an effect of war. The Commission decided that acts of Germany consisting in taking lives of individuals were not the proximate cause: "In striking down the natural man, Germany is not in legal contemplation held to have struck every artificial contract obligation, of which she had no notice, directly or remotely connected with that man. The accelerated maturity of the insurance contracts was not a natural and normal consequence of Germany's act in taking the lives, and hence not attributable to that act as a proximate cause"[5].

Secondly – foreseeability, in that meaning is seen as a legal contemplation. In plain words the wrongdoer must reasonably foresee the effects which are caused by his action. It means that foreseeability should be taken into account from the legal perspective, and by that is focused on a final result of the wrongful act. Proximate causation according to above mentioned approach takes into account fact-in-law analysis[6] and by that does not require proving that the wrongdoer actually foresaw the consequences, but only that latter objectively could be foreseen. To give an example from a judicial practice, popular description of foreseeability was given in US and British commissioners' joint report submitted in 1904 regarding the Samoan dispute: "damages for which a wrongdoer is liable are the damages which are both, in fact, caused by his action, and cannot be attributed to any other cause, and which a reasonable man in a position

[5] Provident Mutual Life Insurance Company and Others (United States) v. Germany, 18 September 1924, US-German Mixed Claims Commission, 7 UNRIAA, p. 113.

[6] L. Castellanos-Jankiewicz, *Causation and international state responsibility*, Amsterdam Law School Legal Studies Research Paper № 2012–56, p. 53.



of the wrongdoer at the time would have foreseen as likely to ensue from his action"[7].

Another influential approach was given in the Umpire of the US-German Claims Commission: "It matters not whether the loss be directly or indirectly sustained so long as there is a clear, unbroken connection between Germany's act and the loss complained of. It matters not how many links there may be in the chain of causation connecting Germany's act with the loss sustained, provided there is no break in the chain and the loss can be clearly, unmistakably, and definitely traced, link by link, to Germany's act... All indirect losses are covered, provided only that in legal contemplation Germany's act was the efficient and proximate cause and source from which they flowed"[8].

It is generally accepted that proximate cause standard has replaced the standard of direct causation, but further reaching question is if that standard is a part of the customary international law. The International Law Commission (ILC) did not choose any of the theories of causation as leading. Explanation to that can be of more practical approach which conforms to adjust meaning of wrongful act to the general framework of rules accepted by ILC and on the other hand it will allow to adjust to the fact pattern and to choose causation standard which will be the most appropriate. Commentary to Article 31 mentions problems of formulating and choosing principle of causation: "the requirement of a causal link is not necessarily the same in relation to every breach of an international obligation[9]".

ILC Article 31(1) provides that "the responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act" further Article 31(2) adds that "injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State"[10]. The requirements of "a sufficient causal link" and proximity "that is not too remote" are main points of the

[7] M. Whiteman, *Damages in International Law*, Vol. 3, Department of State Publications, Washington, DC, 1943, pp. 1779–1780.

[8] Administrative Decision № II, 1 November 1923, US-German Claims Commission, 18 American Journal of International Law (1924), par. 603.

[9] ILC Articles on State Responsibility in Yearbook of the International Law Commission 2001, vol. II, Part Two Commentary to Article 31, p. 93.

[10] Ibidem.

cited text. To meet the requirement of sufficiency, injury must originate from the wrongful conduct as a matter of course and in normal sequence, so sufficiency is here an objective standard and as for proximity, a direct relationship between wrongful act and injury must be visible, in order to exclude irrelevant facts[11]. According to that approach the proximity damages which are 'too remote' from the wrongful act cannot be the subject of a compensation.

The proximity and sufficiency causal test presented in ILC can be seen like a test of fact and law, using examples given by Hart and Honoré question concerning fact will state "Would Y have occurred if X had not occurred?" and question of law "Is there any principle which precludes the treatment of Y as the consequence of X for legal purposes?"[12].

In Professor Stern's opinion this approach is not valid. She arguments that primary rules do not include casual element: "even if in certain cases the primary rule gives rise to some causal link problems, it cannot be the same causation as the one which arises when the primary rule is breached"[13].

In next part author will concentrate on questions of causation in investment arbitration practice and theory.

NAFTA articles 1116 and 1117 provide that and investor may seek compensation for losses which occur by "reason of, or arising out of" a state measure violating NAFTA[14]. In *SD Myers v. Canada* tribunal stated that: "damages may only be awarded to the extent that there is a sufficient causal link between the breach of a specific NAFTA provision and the loss sustained by the investor. Other ways of expressing the same concept might be that the harm must not be too remote, or that the breach of the specific NAFTA provision must be the proximate cause of the harm"[15].

[11] L. Castellanos-Jankiewicz, *Causation...*, p. 45.

[12] Ibidem, p. 110.

[13] B. Stern, *The Obligation to Make Reparation*, [in:] J. Crawford, A. Pellet and S. Olleson, *The Law of International Responsibility*, Oxford University Press 2010, p. 564–571 at 570.

[14] S.A. Alexandrov and J.M. Robbins, *Proximate Causation, Sauvant, Karl P (2009-05-19) International Investment Disputes*, Yearbook on International Investment Law & Policy 2008–2009, Oxford University Press, p. 322.

[15] S.D. Myers, Inc. v. Canada, UNCITRAL, Second Partial Award, October 21, 2002, p. 140.



In next case under NAFTA, *Methanex v. United States,* Tribunal also used proximate causation standard but this time the decision was originated on article 1101. That article provides that Chapter 11 is applicable to measures adopted or maintained by a party relating to accordingly investor or investment. Tribunal pointed out that even though article 1116 is more useful for finding causation principles, it cannot be taken into consideration at the jurisdictional phase of the dispute[16]. Tribunal stated that proximate causation was present in both Canadian and United States legal systems, what implied that both states intended to incorporate it into the treaty[17]. At this point author finds Tribunal's explanation somewhat too simplified. Apart from Canada and United States, the party to NAFTA is also Mexico and in order to decide if proximate causation was to be used also Mexican legal system had had to be analyzed. Only after these analyses the Tribunal could define the will of the parties and by that whether proximate causation notion was one to be chosen.

In order to use proximate causation standard without a specific textual grounds in treaties Tribunals used the wording of treaties, that disputes are to be governed by „the general principle of international law". That kind of approach was presented in *Saluka v. Czech Republic*[18]. In cases before ICSID, the same approach was used on the basis of article 42 of the ICSID Convention, which allows incorporation of causation principles from international and domestic law of the host state[19]. Even in absence of any treaty-based mechanism, tribunals may still apply proximate causation to investment disputes[20].

One of the main topics of proximate causation, which has been repeatedly approached in doctrine and practice is the question of scope of liability. To answer this question the test of foreseeability, directness and proximity can be used[21].

[16] Methanex v. United States, UNCITRAL, Partial Award, August 7, 2002, p. 85–86.

[17] Ibidem.

[18] Saluka Investments BV (The Netherlands) v. Czech Republic, UNCITRAL.

[19] ICSID Convention Article 42 ("The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable").

[20] S.A. Alexandrov and J.M. Robbins, *Proximate...*, p. 324.

[21] ILC Articles on State Responsibility..., p. 93.

First criterion „directness" was adopted in in *Alabama Claims*. United States wanted compensation for damages arising from Great Britain's actions such as providing of ships to Confederacy during the American Civil War. Britain objected to claims for losses caused by prolongation of war and spending more costs on „suppression of the rebellion"[22]. The Alabama Claims Tribunal agreeded with Great Britain and dismissed the challenged categories.

Later on, this approach was repeated in *Trial Smelter* case, which concerned harm caused by sulfur fumes which traveled from Canadian smelter into United States territory. The United States claimed compensation for loss of businesses, the loss of goods by residents of the area which was damaged by fumes (some people could not perform they businesses in the future because they were based on environmental conditions of the area)[23]. Tribunal found that damage of this nature "due to reduced economic status of residents in the area is too indirect, remote, and uncertain to be appraised and not such for which an indemnity can be awarded. None of the cases cited by counsel sustain the proposition cited that indemnity can be obtained for an injury to or reduction in a man's business due to inability of his customers or clients to buy, which inability or impoverishment is caused by a nuisance. Such damage, even if proved, is too indirect and remote to become the basis, in law, for an award of indemnity"[24].

In investor – state proceedings test of indirectness was adopted in *S.D. Myers v. Canada*. The Tribunal used proximate causation notion to limit types of harm for which state could be found liable. U.S. Company S.D. Myers which was importing from Canada a chemical waste product in order to treat it in United States. When S.D. Myers entered Canadian territory local companies were worried about new competition. Canada in order to protect domestic companies enacted regulations prohibiting the export of those specific chemical wastes to the United States excluding by that S.D. Myers from Canadian market.

[22] M. Whiteman, *Damages in International Law*, Vol. 3 (Department of State Publications, Washington, DC, 1943), pp. 1773 (citing Case of the United States, Geneva Arbitration, I Papers Relating to the Treaty of Washington (1872) 185; J.C. Bancroft Davis, Report (1873) 21, protocol V, Record of the Proceedings of the Tribunal of Arbitration at the Fifth Conference held at Geneva, in Switzerland, on the June 19, 1872).

[23] Trail Smelter (U.S. v. Can.), 3 RIAA 1905, 1931 (1941).

[24] Ibidem.



Latter brought claims against Canada seeking compensation for the profits which it would earn from its business model and lost because of the restrictions imposed. Company claimed compensation for „lost investment opportunity" and as a result profits which it would earn. Canada objected to S.D. Myers' claims on the basis of the proximate causation standard claiming that damages of "lost investment opportunity" were to remote and by that could be ground of claims presented by S.D. Myers. Parties claimed differently whether damages were "foreseeable" results of the export ban. The Tribunal stated that foreseeability is more close to domestic contract law and is to show parties intent at the time of concluding the contract. The tribunal deemed that remoteness is better for investment treaty claims like those in S.D. Myers, because latter are more akin to tort actions. Tribunal awarded damages for lost of profits but did not for "lost investment opportunity" because they were too remote[25].

In other known case – *Methanex v. United States* the Tribunal also relied on the proximate causation test in somewhat different way: to limit that investors could claim damages resulting from the regulatory measures[26]. Methanex was a Canadian company which produced methanol in Canada in order to sale it later in the United States. Methanol was mostly used by manufacturers of MTBE, a chemical substance which included methanol which was used in gasoline. According to Methanol it supplied most of its product to California. In 1999 California prohibited sale of gasoline containing MTBE. Methanex claimed that it was done in order to promote U.S. manufacturers of ethanol with which competed with MTBE and as the result of prohibition sales of methanol on U.S. market were vastly reduced[27].

Methanex filed claims against the United States under NAFTA. The United States raise few defenses. One of them was invoking article 1116 of NAFTA stating that its language invoked a proximate causation requirement. According to U.S. California measures had only indirect effect on Methanex's sales. The United States analogized Methanex's

[25] S.D. Myers, Inc. v. Canada, UNCITRAL, Second Partial Award, October 21, 2002, p. 147.

[26] S.A. Alexandrov and J.M. Robbins, *Proximate Causation, Sauvant, Karl P (2009-05-19) International Investment Disputes*, Yearbook on International Investment Law & Policy 2008–2009, Oxford University Press, p. 324.

[27] Methanex v. United States, UNCITRAL, Partial Award..., p. 46–70.

claims to domestic actions for interference with future contractual relations for example with MTBE producers, which under many domestic laws could not cause liability unless it was intentional[28]. Methanex answered that causation standard was fulfilled if harm to the investment was a "reasonably foreseeable" result of taken actions[29]. United States answered in similar manner but on the bases of article 1101 of NAFTA last required "legally significant connection" between measure taken by the state and the investor or his investment. United States argued that measures were "related to" MTBE not to methanol. Methanex counterclaimed that article 1101 was satisfied if the particular measure "affected" the investor or investment[30].

The Tribunal in its Partial Award focused on the United States' Article 1101 argument. Discussion was started with view of" object and purpose". Tribunal stated that if the threshold provided by Article 1101(1) was merely one of "affecting" "it would be satisfied wherever any economic impact was felt by an investor or an investment. For example, in this case, the test could be met by suppliers to Methanex who suffered as a result of Methanex's alleged losses, suppliers to those suppliers and so on, towards infinity. The threshold which could be surmounted by an indeterminate class of investors making a claim alleging loss is no threshold at all. It may be true, to adapt Pascal's statement, that the history of the world would have been much affected if Cleopatra's nose had been different, but by itself that cannot mean that we are all related to the royal nose. The Chaos theory provides no guide to the interpretation of this important phrase; and a strong dose of practical common-sense is required"[31].

Tribunal farther stated that: "The possible consequences of human conduct are infinite, especially when comprising acts of governmental agencies; but common sense does not require that line to run unbroken towards an endless horizon. In a traditional legal context, somewhere the line is broken; and whether as a matter of logic, social policy or other value judgment, a limit is necessarily imposed restricting the consequences for which that conduct is to be held accountable.

[28] Methanex, p. 86.

[29] Methanex's Rejoinder on Jurisdiction, Admissibility and Proposed Amendment, May 25, 2001, paras 11–16.

[30] Methanex's Counter-Memorial on Jurisdiction, February 12, 2001, pp. 46–51.

[31] Methanex's... , p. 137.



For example, in the law of tort, there must be a reasonable connection between the defendant, the complainant, the defendant's conduct and the harm suffered by the complainant; and limits are imposed by legal rules on duty, causation and remoteness of damage well-known in the laws of both the United States and Canada. Likewise, in the law of contract, the contract-breaker is not generally liable for all the consequences of its breach even towards the innocent party, still less to persons not privy to that contract"[32].

The Tribunal accepted the United States' approach to "legally significant connection" and stated that mere fact of ban of methanol was not enough, Methanex had to show, according to Tribunal, that the ban was designed with deliberate intent of harming foreign producers of methanol[33].

Like in S.D. Myers, *Methanexs* Tribunal choose remoteness test over the foreseeability test. Tribunal focused on the fact whether there were links in the causal chain between the California regulation and the harm caused to investor – Methanex, and become to conclusion that protection of NAFTA did not cover that kind of link.

In *CME v. Czech Republic,* the standard of foreseeability was used. In that case governmental agency took certain steps towards diminishing investor's rights under Czech law allowing by that vulnerability of the investor to some actions taken by his business partner. Czech Republic argued that too much time elapsed between regulation and investor's losses. The tribunal did not agree with that explanation stating that "the mere lapse of time" does not diminish the state's responsibility and that causation arises when damage or disadvantage deriving from the legal safety of the investment can be foreseen and when it occurs in a normal chain of links[34].

Next topic, connected with proximate causation doctrine is an intervening cause which contributes to the harm effect. Application of this cause in investment arbitration practice is also quite variable. In U.S. – Iran Claims Tribunal's decision in *Otis Elevator Corp against Iran. U.S.* company purchased shares in two elevator production com-

[32] Methanex's..., p. 138.

[33] Methanex v. United States, UNCITRAL, Partial... , p. 147.

[34] CME Czech Republic B.V. v. Czech Republic, UNCITRAL, Partial Award, September 13, 2001, p. 527.

panies situated in Iran. A group of workers forced managers of the other company to transfer funds from the latter to the company of those workers, which was eventually nationalized. Claimant alleged that government of Iran conspired with the workers in whole situation. Tribunal did not agree with that claim. Accordingly, arbitrators adopted view that loss of funds was caused by workers and rejected the claim: "the Tribunal is not convinced that the Claimant has established that the infringement of these rights was caused by conduct attributable to the Government of Iran. The acts of interference determined by the Tribunal as being attributable to Iran are not sufficient in the circumstances of this Case, either individually or collectively, to warrant a finding that a deprivation or taking of the Claimant's participation in Iran Elevator had occurred"[35].

In *Saluka Investments BV v. Czech*, Dutch investor invested in a newly-privatized Czech bank. The bank later had financial difficulties, became insolvent, and as a result was placed into forced government administration. The investor stated that before the bank's insolvency, Czech government had denied the bank financial help, but at the same time provided such assistance to Czech-owned competitors. In addition, the investor claimed that the government had revealed non-public information regarding the bank's problems, which had pushed it towards insolvency. The investor commenced arbitration under the Netherlands-Czech BIT.

The Tribunal in that case agreed with the investor and found that the Czech government indeed violated the BIT. While discussing question of the leaking of information on the bank, the tribunal faced a joint causation issue, even though the government argued that what was revealed by the media was a simple information reported publicly[36]. The government stated it was impossible show the connection or to determine whether the bank insolvency was caused by the governmental leeks.

Under the Tribunal's approach, the critical question was whether the government leaks had constituted losses and by that whether revealing

[35] S.A. Alexandrov and J.M. Robbins, *Proximate Causation*, ..., p. 333, citing: Award № 304-284-2 (29 Apr. 1987), reprinted in 14 IRAN-U.S. CL. TRIB. REP. 283, 299–300.

[36] Saluka Investments BV v. Czech Republic, PCA, Partial Award, March 17, 2006, p. 479.



the information by the government caused the forced administration of the bank[37]. Tribunal found that even though the press informed about problems of the bank, it was information which government revealed "contributed in all probability" to the insolvency of the bank and as a result to forced administration[38]. Tribunal has stated that government could not escape responsibility by trying to show a contributor to the investors loss in face of media.

Slightly different approach to causation was used in more recent case *Yukos Universal Limited (Isle of Man) v. The Russian*. Tribunal in this case stated that: "The Tribunal holds that Claimants do, in fact, establish that a specific series of actions of Respondent, consisting of the 2000–2004 tax assessments against Yukos and the subsequent enforcement measures (including the forced auction of YNG), constituted an illegal. In particular, the 2000–2004 tax assessments were actions that contributed to the expropriation of Claimants' investment, and without these assessments, the damage to Claimants would not have occurred"[39]. Analysis of this text show that Tribunal did not point out which type of causation was used. Tribunal compactly stated that tax assessments caused damage to the claimants. From the perspective of direct causation action of the Russian Federation is hard to be seen as in direct connection with the loss. On the other hand, proximate causality test was not fully used by the Tribunal and as a result it is hard to reconstruct *Yukos* case approach to causality.

This award is showing that tribunals often mention causation without pointing exact test they used to describe it. Some tribunals seem to use constructions which resemble at the same time direct causation and proximate causation.

Cases mentioned in this work and approaches to the theme of causation in international investment arbitration are showing that issue is approached from different perspectives. In most cases tribunals reached in similar fact patterns same conclusions but with different mind process. Tribunals mostly did not agree with holding states liable for the harm which was according to the tribunals insufficiently

[37] Saluka, p. 480.

[38] Saluka, p. 480–481.

[39] Yukos Universal Limited (Isle of Man) v. The Russia Federation, Final Award July 18, 2014 (Retrieved April 24, 2016 from: http://www.italaw.com/sites/default/files/case-documents/italaw3279.pdf,), p. 1772.

related to a wrongful act. On the other hand, tribunals were ready to trace the causal link even though it was extended in time.

There is and probably there will be uncertainty in choosing methods of reconstructing causation chain. According to author of this work there is no need to accept only one approach as universal for all the situations concerning causation, because concept of causation is on itself very differentiated and has many loops, that is why it is predestinated to be elastic and give only basic instruments to show connection between wrongful act and direct or indirect losses.