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Nicole Grmelová (ed.)

# Challenges of Law in Business and Finance

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# Challenges of Law in Business and Finance

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Jan Skrabka is a Ph.D. Candidate at the Department of Business and European Law, Faculty of International Relations, Prague University of Economics and Business, Czech Republic. He graduated from the master's programme at the Charles University Law School, Prague, Czech Republic. Moreover, he also graduated from a double degree M.A./M.Sc. programme Advanced International Business Management organized by the Newcastle University (United Kingdom) and the University of Groningen (Netherlands). Finally, he obtained his master's degree in Computer and Systems Sciences specializing in Decision Support and Risk Analysis. Besides his academic activities, he works as a Consultant and Special Projects Manager. He is a member of the The Italian Society of Law and Economics (SIDE).

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**Study visits**

During his business studies Jan Skrabka spent a semester at Erasmus study programme at the University of Tartu (Estonia). During his doctoral studies he participated in a semestral Erasmus+/Swiss-European Mobility Programme at the University of Bern (Switzerland), and in a study visit at the Humboldt-Universität zu Berlin (Germany). He participated at the summer school organized by the University of Graz, and in many international conferences, such as the 17th annual conference of the Italian Society of Law and Economics held at the University of Trento (Italy) in 2021, or the Annual Conference on EU Financial Regulation and Supervision 2021 organized by ERA in Brussels (Belgium).

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**Publications**

Nicole Grmelová published a university textbook on European Business Law (*Vybrané kapitoly z Evropského obchodního práva*. 1st ed. Prague: Nakladatelství Oeconomica, 2015), a textbook on Fundamentals of Law for foreign students attending the Prague University of Economics and Business (*An Introduction to Law*. 1st ed. Prague: Powerprint, 2019). In 2020 Nicole Grmelová published a book chapter on the new legal framework of the sales agreement under Czech law in French (*La recodification du contract de vente dans le droit civil tchéque*. In: BOUCARD, Héléne, LETE, Javier, SCHÜTZ, Rose-Noëlle, SAVAUX, Éric, PAZOS, Ricardo. *La recodifications du droit de la vente en Europe. Actes & colloques*. Poitiers: Presses universitaires juridiques – Université de Poitiers, 2020). Also, she is the author or co-author of dozens of peer reviewed papers; most recently she co-authored a paper on the "Legal rights of private property owners vs. sustainability transitions?" published in the *Journal of Cleaner Production* in 2021, Vol. 323 (10), pp. 1–32.

**Study visits**

During her academic career Nicole Grmelová participated in a number of teachers' mobility exchanges under the Erasmus+ teacher mobility scheme, including the Turiba University in Riga (Latvia), University of Turku (Finland), ISCTE University Institute of Lisbon (Portugal), and the University of Economics in Bratislava (Slovakia). She also took part in a Summer School organized by the University of Urbino (Italy), Center for European Legal Studies: "Seminar of Comparative and European Law/Séminaire de droit comparé et européen" in 2018. Nicole Grmelová established a teacher exchange cooperation between the Prague University of Economics and Business and the University of Santiago de Compostella (Spain) where she also engaged as an external expert of a research grant on consumer rights under EU Law funded by the Spanish Ministry of Science and Innovation.

**Jan Skrabka (ed.)** **Nicole Grmelová (ed.)**

# Challenges of Law in Business and Finance

Conference proceedings
*13th International Scientific Conference "Law in Business of Selected Member States of the European Union"*
November 4-5, 2021, Prague, Czech Republic

ADJURIS
International Academic Publisher

Bucharest, Paris, Calgary 2021

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ISBN 978-606-95351-1-0 (E-Book)


Editing format .pdf Acrobat Reader
Bucharest, Paris, Calgary 2021

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# Foreword

Dear Ladies and Gentlemen, Dear Readers,

These conference proceedings constitute a selection of the best papers submitted to the 13th International Scientific Conference "Law in Business of Selected Member States of the European Union" which was organized by the Department of Business and European Law, Faculty of International Relations, Prague University of Economics and Business, Czech Republic. The conference was held in the University´s premises on 4 and 5 November 2021 and welcomed speakers and participants from both Europe (United Kingdom, Denmark, France, Ireland, Belgium, Lithuania, Sweden, Poland, Slovakia, and the Czech Republic) and overseas (Saudi Arabia, Turkey, and South Korea). Given the ongoing Covid-19 related travel restrictions the conference was held in a hybrid format, being streamed online for those who could not join the conference venue in person. Unlike the conference events held in the past years, this conference has grown much more international. The papers were submitted and presented in English. All the papers included in this volume passed a rigorous double-blind peer review successfully and were checked for their originality using the iThenticate software kindly provided by the University.

The participants´ papers were presented in specialized sections which correspond to the subheadings of the present volume:

1. Section: Banking, Finance, and Insurance Law
2. Section: Competition Law
3. Section: Insolvency Law
4. Section: European and International Legal Aspects of Doing Business
5. Section: IT Law
6. Section: Interference of Business and Constitutional Law

The conference has been supported by the Internal Grant Agency Project No. F2/74/2021 "*Law in Business of Selected Member States of the European Union (13th annual conference)"* of the Prague University of Economics and Business.

All published papers successfully passed the double-blind peer-review process by at least 2 independent reviewers - experts with a PhD in the relevant field.

The conference organizers will be happy to welcome the readers at the conference to be held next year on 3 and 4 November 2022. For more information on the call for papers for the upcoming conference please check the conference webpage at https://lawinbusiness.vse.cz/.

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# SECTION I
# BANKING, FINANCE AND INSURANCE LAW

# Crypto-asset services under the draft MiCA Regulation

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***Abstract:*** *The draft Markets in Crypto-assets Regulation (MiCAR) seeks to regulate crypto-asset services and service providers as an area, which was mainly built on the idea of independence from the current financial system and its regulatory framework. MiCAR, inspired by the Markets in Financial Instruments Directive (MiFID II) as a cornerstone of the EU financial services regulation, now aims to change the paradigm. The paper deploys cross-sectoral approach, focuses on examining the scope and categorising the relevant crypto-asset services compared with the "traditional" investment services catalogue under MiFID II. By analysing the definitions and content of individual services, it seeks to identify possible differences. It also examines the impacts MiCAR might have on how the scope of individual corresponding investment services under MiFID II is interpreted, and vice versa. As a result, the paper introduces three categories of crypto-asset services and emphasizes the relevant differences from the MiFID II list.*

***Keywords:*** *Crypto-asset services; investment services; MiCAR; MiFID II.*

## INTRODUCTION

In fall 2020, the long-awaited draft Markets in Crypto-assets Regulation (MiCAR)[1] was finally published by the European Commission[2]. It seeks to lay down EU-wide uniform rules on issuance, admission to trading, as well as providing selected services related to crypto-assets other than financial instruments, that is namely currency tokens,[3] utility tokens and stablecoins.[4] It includes authorization and prudential requirements, as well as consumer protection and supervisory rules.

[1] Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and Amending Directive, COM (2020) 593 final. [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020PC0593&from=EN.

[2] The research was supported by Charles University, project PRIMUS HUM/17 "Europeanization as a determiner of legal regulation of financial services and taxation" implemented at the Faculty of Law, Charles University, Prague, in 2021.

[3] „E-money tokens" under MiCAR.

[4] „Asset-referenced tokens" under MiCAR.

Targeting the ecosystem, which was mainly built on the idea of decentralization[5] and independence from current financial system[6] and its regulatory framework and coming with some of the "traditional" regulatory institutes, inspired by the Markets in Financial Instruments Directive (MiFID II)[7], MiCAR has unsurprisingly provoked discussion not only among crypto-asset market participants, but within academia as well. The research has yet focused plausibly on the overall evaluation of MiCAR, rather than analysing closely the individual institutes.

As a contribution to the ongoing scientific debate, the present paper focuses on analysing and categorising individual crypto-asset services compared with the "traditional" investment services catalogue under MiFID II. The involved methodology makes use of cross-sectoral approach, targeting the definitions and scope of crypto-asset services and corresponding investment services. Subsequently, it seeks to identify possible relevant differences, which might potentially contradict the level playing field principle[8] and which further research shall examine to ensure investor protection.[9]

## 1. CRYPTO-ASSET SERVICES AND RELATION TO MIFID II INVESTMENT SERVICES LIST

Conditions and requirements for providing the crypto-asset services present one of the central elements of MiCAR. MiCAR includes a wide list of services and activities relating to crypto-assets, which qualify as crypto-asset services under the proposed regulatory regime, namely the following:

a) the custody and administration of crypto-assets on behalf of third parties (i.e. wallet providers);
b) the operation of a trading platform for crypto-assets;
c) the exchange of crypto-assets for fiat currency that is legal tender;

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[5] In detail WALCH, Angela. Deconstructing "Decentralization": Exploring the Core Claim of Crypto Systems. In BRUMMER, Chris. *Cryptoassets*. New York: Oxford University Press, 2019, 9780190077310. pp. 39-68.

[6] In detail HACKER, Philipp, Ioannis LIANOS, Georgios DIMITROPOULOS and Stefan EICH. 2019. *Regulating Blockchain*. Oxford: Oxford University Press, 2019, 443, pp. 6-9. 9780198842187.

[7] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014L0065&qid=1633640513712&from=EN.

[8] In detail COLAERT, Veerle, BUSCH, Danny and Thomas INCALZA. *European Financial Regulation. Levelling the Cross-Sectoral Playing Field*. Oxford: Hart Publishing, 2019, 482 p. 9781509926459.

[9] HERRING, Richard J., and Anthony M. SANTOMERO, *What is optimal financial regulation?* The Wharton School. University of Pennsylvania. [online]. 1999. [viewed 10. September 2021]. Available from: https://www.researchgate.net/publication/23739233_What_Is_Optimal_Financial_Regulation, pp. 2-11.

d) the exchange of crypto-assets for other crypto-assets;
e) the execution of orders for crypto-assets on behalf of third parties;
f) placing of crypto-assets;
g) the reception and transmission of orders for crypto-assets on behalf of third parties; and finally
h) providing advice on crypto-assets.[10]

To qualify as crypto-asset service, the activity shall relate to crypto-assets as defined by MiCAR.[11] This seems rather straightforward, but it is worth noting that because of such a condition, services related to crypto-assets which qualify as financial instruments, such as security/asset tokens, will not present crypto-asset services under MiCAR, but rather more rigorously regulated investment services. As such, they will be covered by existing rules, namely MiFID II and related legislation.

Following from the current research,[12] we shall note that the scope of the term "financial instrument" in relation to crypto-assets remains unclear in many respects, mainly due to partly different transpositions of the relevant term into the national legislations of individual Member States. This causes unlevel playing field, opens space for regulatory arbitrage, and raises uncertainty when interpreting the scope of MiCAR.[13]

Comparing the crypto-asset services list and the corresponding list of investment services in the relevant MiFID II annex,[14] the inspiration is apparent, as the services show similarities.[15] MiCAR clearly expresses its aim to approximate both categories of services in various provisions, maybe the most prominently in relation to special regime for investment firms authorised under MiFID II when providing crypto-asset services. As a result of such an approach, the investment firms licensed under MiFID II are authorised to provide the relevant crypto-asset services under MiCAR, which correspond to the investment services they provide under their respective MiFID II authorisation, without needing to obtain the additional authorisation under MiCAR.[16]

A comparison of the two respective lists allows us to make distinction between "genuine" crypto-asset services, out-of-scope services, and finally

[10] Cf Art. 3 1 (9) MiCAR.
[11] Cf. Art 3 1 (2) MiCAR.
[12] Cf HACKER, Philipp and THOMALE, Chris, Crypto-Securities Regulation: ICOs, Token Sales and Cryptocurrencies under EU Financial Law. *European Company and Financial Law Review.* [online]. 2018(15), 645-696. 1613-2556. [viewed 20 September 2021]. Available from: https://ssrn.com/abstract=3075820.
[13] ZETZSCHE, Dirk Andreas, ANNUNZIATA, Filippo, ARNER, Douglas W. and BUCKLEY, Ross P. The Markets in Crypto-Assets Regulation (MICA) and the EU Digital Finance Strategy. Capital Markets Law Journal. 2021, 16(2), 208-209.
[14] Cf Annex I Section A, Section B (1) MiFID II.
[15] ZACHARZEWSKI, Konrad. Digital asset capital market law: A new discipline of private law. „Krytyka Prawa. 2021. 13(2), 204.
[16] Cf Art. 2 (6) MiCAR.

crypto-asset services materially corresponding to the relevant investment services.

## 2. "GENUINE" CRYPTO-ASSET SERVICES

The first category presents unique, genuine services listed in MiCAR, relevant only in case of crypto-assets, following from the specific nature of this asset class. These are namely both services relating to the exchange of crypto-assets, either for fiat currency that is legal tender or other crypto assets.[17] These services comprise of concluding purchase or sale contracts concerning crypto-assets with third parties against fiat currency or other crypto-assets by using proprietary capital of the service provider.[18] Somewhat surprisingly, MiCAR does not cover exchange of crypto-assets for financial instruments.[19] This is suboptimal and may pose threat to the investor protection principle, since the complexity of transaction and risks related to such an exchange might generally be higher than in case of crypto-fiat or crypto-crypto exchange scenario.

## 3. OUT-OF-SCOPE SERVICES

Some of the services theoretically applicable to both crypto-assets and financial instruments are, however, not covered by the MiCAR crypto-asset services list.

Namely, in contrast to MiFID II, MiCAR's crypto-asset services catalogue does not include portfolio management. This is rather surprising, since managing portfolio of crypto-assets on client-to-client basis and namely collective basis based on the mandate given by the investors is already nowadays activity widely undertaken by many managers.[20] Arguably, we might mitigate such a deficiency by interpretation, considering portfolio management in relation to crypto-assets as simultaneous provision of two listed services, advice and the reception and transmission of orders. It seems, however, unreasoned not to include such a service in the MiCAR catalogue expressly, since regarding the related risks and complexity, it generally corresponds to the portfolio management of financial instruments as investment service under MiFID II.

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[17] Categorisation of exchange services as specific services is supported by MAIA, Guilherme and VIEIRA DOS SANTOS, João, MiCA and DeFi ('Proposal for a Regulation on Market in Crypto-Assets' and 'Decentralised Finance'). *Forthcoming article in "Blockchain and the law: dynamics and dogmatism, current and future"; Eds: COUTINHO, Francisco Pereira, PIRES, Martinho Lucas and BARRADAS, 4.* [viewed 20 September 2021]. Available from: https://ssrn.com/abstract =3875355.

[18] Cf Art. 3 1 (12), (13) MiCAR.

[19] ZETZSCHE, Dirk Andreas, ANNUNZIATA, Filippo, ARNER, Douglas W. and BUCKLEY, Ross P. The Markets in Crypto-Assets Regulation (MICA) and the EU Digital Finance Strategy. Capital Markets Law Journal. 2021, 16(2), 217.

[20] Ibid, 217.

Regarding the investment service of dealing on own account, defined by MiFID II as trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments,[21] MiCAR does not bring fully corresponding crypto-asset service. It does, however, include dealing on own account as an integral part of providing the crypto-asset service of exchange of crypto-assets, that is by using proprietary capital of the respective service provider.[22] Furthermore, MiCAR expressly bans service providers that are authorised for the operation of a trading platform for crypto-assets from dealing on own account on the platform they operate, even when they are authorised for the crypto-fiat or crypto-crypto exchange services.[23]

## 4. MIFID II CORRESPONDING SERVICES

Finally, there are services either fully identical to the corresponding investment services or services, whose definition and statutory content differs slightly from the respective MiFID II templates due to the different nature of crypto-assets, but materially correspond to their MiFID II templates. In both mentioned cases, the content of such services tends generally to be described in a more detailed manner in MiCAR.

### 4.1. Fully identical services

The fully identical services include, first, execution of orders for crypto-assets on behalf of third parties, defined as concluding agreements to buy or to sell one or more crypto-assets or to subscribe for one or more crypto-assets on behalf of third parties. This corresponds to the respective service under MiFID II, defined as acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients and includes the conclusion of agreements to sell financial instruments issued by an investment firm or a credit institution at the moment of their issuance. The slight difference in wording (using the term "to subscribe" in case of the crypto-asset service and the term "sell" at the moment of their issuance in case of investment service) has no material effect, as both of the service aim at the primary, as well as secondary market.[24]

Second, it is the reception and transmission of orders for crypto-assets on behalf of third parties, defined as reception from a person of an order to buy or to sell one or more crypto-assets or to subscribe for one or more crypto-assets and the transmission of that order to a third party for execution.[25] Unlike MiFID II, MiCAR does not provide expressly that this crypto-asset service also includes

[21] Cf Art 4 1 (6) MiFID II.
[22] Cf Rec (12), Art 3 1 (12), (13) MiCAR.
[23] Cf Art 68 3 MiCAR.
[24] Cf Art 3 1 (14) MiCAR and Art 4 1 (5) MiFID II.
[25] Cf Art 3 1 (16) MiCAR.

bringing together two or more investors, thereby bringing about a transaction between those investors.[26] We might, however, deduce this conclusion by means of analogy, nevertheless with the limits stressed out by the Court of Justice of the EU in its recent *Khorassani* case.[27] Notably, the definition of the service above in relation to crypto-assets includes the term "subscription" and may thus lead to the conclusion that this service may be provided at the primary as well as secondary crypto-asset market. In case of investment services, this conclusion was not entirely clear, as the activities undertaken towards prospective investor in financial instruments at the primary markets were either considered solely as placing of financial instrument, or combination of placing (from the issuer's perspective) and reception and transmission of orders (from the investor's perspective). In this respect, MiCAR could help to overcome the uncertainty as it seems to support the latter conclusion.

Third, it is providing advice on crypto-assets, defined as offering, giving or agreeing to give personalised or specific recommendations to a third party, either at the third party's request or on the initiative of the crypto-asset service provider providing the advice, concerning the acquisition or the sale of one or more crypto-assets, or the use of crypto-asset services.[28] The comparison with MiFID II investment advice, defined as provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments,[29] allows for two conclusions. It shows emphasis on „specific recommendation", in addition to the "personalised recommendation" as well as on the preparatory stages of the actual provision of the advice to the client. The practical impact of this wording is questionable, from the current MiFID II interpretation perspective it seems rather limited. Furthermore, and prominently, advice concerning the use of crypto-asset services (or a specific service) would fall expressly into the scope of MiCAR. This is a crucial difference from the narrower investment advice definition under MiFID II, as the advice to use specific investment service or services does not generally qualify as investment advice under MiFID II, provided it does not relate to one or more transactions relating to (specific) financial instruments.

### 4.2. Materially corresponding services

The MiFID II corresponding crypto-asset services, whose definition and statutory content slightly differs due to the nature of crypto-assets, comprise of

[26] Cf Rec (44) MiFID II.
[27] Judgement of the Court of Justice of the EU of 14 June 2017. Mohammad Zadeh Khorassani v. Kathrin Pflanz. Case C-678/15 [online]. In EUR-Lex. [viewed 30. September 2021]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62015CJ0678&from=en.
[28] Cf Art 3 1 (17) MiCAR.
[29] Cf Art 4 1 (4) MiFID II.

operation of a trading platform for crypto-assets, the custody services and placing of crypto-assets.

The first service, defined as managing one or more trading platforms for crypto-assets, within which multiple third-party buying and selling interests for crypto-assets can interact in a manner that results in a contract, either by exchanging one crypto-asset for another or a crypto-asset for fiat currency that is legal tender, covers both crypto-crypto and crypto-fiat trades.[30]

The second service, defined as safekeeping or controlling, on behalf of third parties, crypto-assets or the means of access to such crypto-assets, where applicable in the form of private cryptographic keys, is modified to cover the crypto-asset nature (ie. wallet custody),[31] but materially corresponds to the ancillary service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services under MiFID II.[32]

Finally, the placing of crypto-assets materially corresponds to the two relevant placing investment services from the MiFID II catalogue, that is underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis and placing of financial instruments without a firm commitment basis.[33] Under MiCAR, the placing consists in the marketing of newly-issued crypto-assets or of crypto-assets that are already issued but that are not admitted to trading on a trading platform for crypto-assets, to specified purchasers, and does not involve an offer to the public or an offer to existing holders of the issuer's crypto-assets.[34] Differently from MiFID II, MiCAR on the one hand does not distinguish between placing on firm commitment and no commitment basis, on the other distinguishes placing from the offer to the public as offer to third parties to acquire a crypto-asset in exchange for fiat currency or other crypto-assets.[35] This is, again, a very interesting difference from MiFID II. Under MiFID II, there has been little doubt that placing of financial instruments could take multiple forms, including the offer to the public under the Prospectus Regulation.[36] This seems to be a consequence of a different approach presented by MiCAR, which considers placing as solely marketing activity. However, the question arises whether this approach is feasible and justified, since marketing activity typically qualifies as offer to the public.

[30] Cf Art 3 1 (11) MiCAR.
[31] Cf Art 3 1 (10) MiCAR.
[32] Cf Annex I Section B (1) MiFID II.
[33] Cf Annex I Section A (6), (7) MiFID II.
[34] Cf Art 3 1 (15) MiCAR.
[35] Cf Art 3 1 (7) MiCAR.
[36] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R1129&from=EN.

## CONCLUSION

Summarizing the research conducted in the present paper, we emphasize the following conclusions.

We may categorize the crypto-asset services introduced by MiCAR as follows. There are genuine or unique services on one hand and services, corresponding to MiFID II investment services on the other. Additionally, there are services regulated under MiFID II, which in case of crypto-assets remain out of scope of MiCAR.

Considering the MiFID II and MiCAR lists, there are differences both in the content of crypto-asset services list and the scope of individual services. Meanwhile some of these differences are well justified by the nature of the crypto-assets as a new asset class, others seem potentially unreasoned. Further research is necessary to determine, whether these might contradict the level-playing-field principle and might thus be sub-optimal from the investor protection perspective.

By applying the analogy principle when interpreting the individual pieces of EU legislation, MiCAR might have impacts on how individual corresponding investment services under MiFID II are interpreted, and vice versa. This is specifically the case of reception and transmission of orders, advice and placing services.

Finally, the above research showed that issues related to the definitions of individual crypto-asset services and their possible effects on the interpretation of the content of the respective services and possibly also investment services under MiFID II might be significant and deserve further attention.

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Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/ legal-content/EN/TXT/HTML/?uri=CELEX:32017R1129&from=EN.

# Regulating Crypto Assets under the Covid-19 pandemic veil: legislation in the EU and the Czech perspective

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***Abstract:*** *This contribution aims to discuss recent regulatory initiatives concerning crypto-assets and to analyse the development on the market of crypto assets with reactions made by regulators. During the Covid-19 pandemic the financial markets, especially crypto assets experienced unprecedented volatility. The economic uncertainty and dynamic rise of crypto assets together with retail investors' higher attention forced regulators to react. Based on the latest market development the contribution shall discuss key elements of the proposal for a regulation on market in crypto assets. After descriptive analysis of the legislative proposals, the weaknesses should be analyses aiming to identify key problematic issues and potential consequences of the proposal. The critical discussion should justify the need for regulations to draw attention to aspects that shall be revised during the legislative process. Special attention is paid to the regulation in the EU and implications for the Czech Republic.*

***Keywords:*** *crypto-assets, digital finance, financial regulation, Covid-19.*

## INTRODUCTION

The year 2020 will be remembered by history as the pandemic year. [1] The spread of the virus later named SARS CoV-2 had the effect of a black swan[2] with unprecedented implications in all of the aspects of human living. Financial markets experienced volatility. Under the shadow of lockdowns, pandemic restrictions and rising public debts, we can find a tiny fraction of the economy, that experienced its significant rise – crypto assets. The year 2020 and 2021 showed that this sector is not a game of a group of IT enthusiasts, but an economic, technological, and social trend that must be a subject of academic research and public debate.

Even before the pandemic has the European Commission included digital

[1] The article has been supported by grant No. F2/60/2021 "Recent Changes in Business, Financial and IT law in the Czech Republic in Response to the Covid-19 Pandemic" of the Prague University of Economics and Business.

[2] The term 'black swan' has been established by N. Taleb. See TALEB, Nassim Nicholas. The Black Swan: The Impact of the Highly Improbable, 2007. Random House Group. ISBN: 978-1-4000-6351-2.

finance as one of its priorities in the EU strategic agenda 2019-2024.[3] In the Banking and Finance legislative plan, we can find "*Digital finance strategy*" as part of political priority for *"Economy that works for People*". The legislative package was intended by the Commission to reflect the new shift of the financial sector in the digital age.[4] The pandemic, however, spilt over the intensity of work by regulators and the file that would probably go smoothly through the legislative process in the EU has been closely monitored not only by stakeholders and lobbyists but by a significant part of the informed public and some retail investors.[5] [6]

## 1. THE COVID-19 AS A DRIVE FOR THE GROWTH OF THE MARKET IN CRYPTO ASSETS

The pandemic caused a market crash in April 2020. Financial markets, however, quickly stabilized and started to benefit from uncertainty in the world economy.[7] At the same time, the market in crypto assets experienced a growing trend and most crypto projects reached a high-speed price increase. Most crypto assets reached their all-time high, which has drawn the attention of mainstream media. For instance, the price of Bitcoin[8] went up from $ 9 100 in March 2020 to break the price of $ 60 000 in the middle of April 2021.[9] A profit vision captured the enormous concerns of retail investors. According to Google trends, the number of searches containing *"crypto"* has increased more than tenfold between December 2020 and April 2021.[10] That indicates the entrance of retail investors into the market. More importantly, the years 2020 and 2021 meant the adoption of institutional investors. Big business players released in 2021 that they hold bitcoin or other crypto assets in their balance sheets.[11] Moreover, the group of

[3] GALARIOTIS Iiannis and Alina THIEME. The European Council's Strategic Agenda 2019-2024, 2020. ISBN: 978-92-9084-842-7. Available from https://cadmus.eui.eu/handle/1814/67068.
[4] EUROPEAN COMMISSION: Digital Finance Package - *European Commission* [online]. Available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1684.
[5] IOSCO. Investor Education on Crypto-Assets – Final Report. December 2020. Available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD668.pdf.
[6] EUROPEAN COMMISSION. Financial services – EU regulátory framework for crypto-assets. Public consultation. Available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12089-Directive-regulation-establishing-a-European-framework-for-markets-in-crypto-assets/public-consultation_en.
[7] GUARDIAN. Global stock markets post biggest falls since 2008 financial crises, 14 March 2020. Available at: https://www.theguardian.com/business/2020/mar/09/global-stock-markets-post-biggest-falls-since-2008-financial-crisis.
[8] Bitcoin is the first crypto asset ever, created in 2009 by Satoshi Nakamoto.
[9] COIN MARKET CAP: Global Cryptocurrency Charts. [29 September 2021] Available at: https://coinmarketcap.com/en/charts/.
[10] GOOGLE TRENDS: crypto. Available at: https://trends.google.com/trends/explore?date=2019-12-01%202021-10-02&q=crypto.
[11] REUTERS. Most institutional investors expect to buy digital assets setudy finds. 20 July 2021. Available at: https://www.reuters.com/business/most-institutional-investors-expect-buy-digital-assets-study-finds-2021-07-20/.

entrepreneurs offering payments in crypto assets is rapidly increasing. The market trend may be demonstrated by the market cap. An increase from $ 194 billion in January 2020 to over $ 2,400 billion in April 2021 was reported. After the fall in April 2021, the market cap was hovering around $ 2,000 billion September 2021.[12]

The development during the pandemic revealed increasing popularity. In addition, the current inflation expectation speaks in favour of crypto investments. Crypto projects are going through the technological progress as well as they regularly update their technological substance to be more competitive and the community is heading to the initial idea – an anonymous, decentralised means of payment that is independent of any public authority. Crypto assets enthusiasts are still dreaming about an alternative that can compete with fiat currencies. Innovative projects of decentralised finance often called "DeFi" aim to even build up and establish financial services based on crypto assets.[13] From 2020 the market experienced crypto saving accounts, crypto investment products, financial instruments, or crypto debit cards.[14] The crypto world has already extended to business with ongoing projects of private coins and digital currencies.[15] The last development showed the market in crypto assets became "*too big to fail*", thus regulators can no longer ignore it. The regulatory initiatives in the preparatory process yet before the Covid-19 pandemic were undoubtedly accelerated the pandemic.

## 2. GLOBAL STANDARDS ON ANTI-MONDY LAUNDERING

The initial subject of regulators when it comes to crypto assets was traditionally the prevention of illegal activities such as anti-money laundering (AML) and countering the financing of terrorism (CFT). The Financial Action Task Force (FATF) in its regular guidance encourages jurisdictions to impose efficient requirements on financial institutions and other business professionals to mitigate risks of crimes coming from crypto assets. Besides widely adopted definitions of virtual assets and virtual assets service providers[16] [17], a set of recommendations are also provided in FATF reports, while those recommendations

[12] COIN MARKET CAP: Global Cryptocurrency Charts. [29 September 2021] Available at: https://coinmarketcap.com/en/charts/.

[13] SHILLIG M. A. Cryptocurrencies. Development and perspectives. In: CHIU I. H-Y and DEIPENBROCK G. Routledge Handbook of Financial Technology and Law. Routledge. 2021 ISBN: 9780429325670.

[14] ZETZSCHE Dirk A, ARNER Douglas W, BUCKLEY Ross P, Decentralized Finance, JOURNAL OF FINANCIAL REGULATION, Volume 6, Issue 2, September 2020, Pages 172–203, DOI: 10.1093/jfr/fjaa010.

[15] REUTERS. London Stock Exchange Group tests blockchain for private company shares. 19 July 2017. *Available at* https://www.reuters.com/article/us-lse-blockchain-idUSKBN1A40ME.

[16] FAFT. Report: Virtual Currencies. Key Definitions and Potential AML/CFT Risks. June 2014. Available at: https://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf.

[17] FATF understands virtual assets as superior class covering crypto assets and other digital assets.

serve as a model for legislators. Aiming to help national authorities to detect any criminal activities connected to crypto assets, standards on virtual assets from Red Flag Indicators by FATF[18] from September 2020 were revised reflecting the latest market trends and new FATF's observations and findings. The regulator's Virtual Asset Service Providers (VASPs) shall receive, and hold information concerning the originator, transfer and beneficiary and make such information available for competent authority upon a request.[19]

## 3. CURRENT ATTITUDES TOWARDS CRYPTO ASSETS REGULATIONS IN THE EU

Regulations on the EU level follow globally acknowledged recommendations by FATF. Union's steps targeted the past threats of money laundering and financing of criminal activities and terrorism. The AML/CFT legislation has been revised in 2018 to fully include crypto assets as a new potential source of unlawful activities. The Directive 2018/843[20], often called the fifth AML directive, established in Art. 1 para 2 (d) the definition of "*virtual currencies*"[21] and targeted virtual asset service providers such as providers engaged in exchanges and custodian wallet providers. Members States were obliged to implement the directive by 10 January 2020 and establish obligations of business registrations and record-keeping for those providers. Moreover, the 5TH AML directive aims to strengthen the information exchange and cooperation between the Member States and Union's Financial Intelligence Units to face the anonymity of crypto assets transactions.[22]

In July 2021 a proposal for a regulation recasting current AML legislation[23] has been released by the Commission. The recast of current Regulation

[18] FATF. Report: Virtual Assets. Red Flags Indicators. September 2020. Available at: https://www.fatf-gafi.org/media/fatf/documents/recommendations/Virtual-Assets-Red-Flag-Indicators.pdf.
[19] FATF. Second 12-month review of the revised FAFT standards on virtual assets and virtual asset service providers. July 2021. Available at: https://www.fatf-gafi.org/media/fatf/documents/recommendations/Second-12-Month-Review-Revised-FATF-Standards-Virtual-Assets-VASPS.pdf.
[20] DIRECTIVE (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU.
[21] The definition of virtual assets in the 5th AML directive reflects definition of virtual assets by FAFT.
[22] COVOLO V. The EU Response to Criminal Misuse of Cryptocurrencies: The Young, already Outdated 5th Anti-Money Laundering Directive. EUROPEAN JOURNAL OF CRIME CRIMINAL LAW AND CRIMINAL JUSTICE. Volume 20, Issue: 3, page 217-251. September 2020. DOI: 10.1163/15718174-bja10003.
[23] Proposal for a REGULATION of the European Parliament and of the Council on information accompanying transfers of funds and certain crypto-assets (recast). 20 July 2021. 2021/0241 (COD).

2015/847 shall expand traceability requirements applicable to funds to crypto assets, which are outside of the legislative scope until now. The Commission recognized the international development of crypto assets transfers and argued in favour of the stricter requirements as the increased use of crypto assets gives a significant threat to the internal market. The same rules on the information on transfers of funds in any currencies will apply to transfers of crypto assets, which shall be according to this regulation treated with the same requirements as for cross-border wire transfers. Before using crypto asset services official personal document of a customer shall be required with date and place of birth. The same identification details will be required for the beneficiary of the transaction. The crypto asset service providers (CASPs) will have to adopt adequate measures and procedures to ensure compliance with such requirements.[24]

Aiming to develop legislation ensuring legal certainty in the market in crypto assets, the European Union set the adoption of crypto legislation as one of its priorities. The Digital Finance Package following up the FinTech action plan[25] was designed to bring legal certainty to digital finance in the EU. The package released by the European Commission in September 2020 consists of four legislative files.[26] The regulation on Market in Crypto Assets (MiCA) is perhaps the most revolutionary file from the package. The proposal for a regulation on Digital Operational Resilience for the financial sector, often referred to as DORA shall face ICT risks in the financial sector with its wide scope covering most financial entities operating on the market, including crypto assets service providers. The DORA proposal imposes the responsibility for ICT risk governance on the management body of a financial entity and creates an EU-harmonised system of ICT-related reporting standards.[27]

The proposal for a Pilot Regime regulation aims to allow the distributed ledger technology (DLT) based secondary financial market to run smoothly. Commission's plans to test the technology in the economy and motivate market players to launch its DLT projects as soon as possible by benefiting from exclusion from certain requirements. The regulation shall allow issuance of shares on DLT with a market cap of up to EUR 200 million, bonds up to EUR 500 market

[24] Ibid.

[25] EUROPEAN COMMISSION: Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions. FinTech Action plan: For a more competitive and innovative European financial sector. COM(2018) 109/2. Available at: https://ec.europa.eu/info/sites/info/files/180308-action-plan-fintech_en.pdf

[26] EUROPEAN COMMISSION: Digital Finance Package - *European Commission* [online]. Available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1684

[27] Proposal for a REGULATION of the European Parliament and of the Council on Digital Operational Resilience for the financial sector and amending Regulations (EC) No 1060/2009, (EU) No 648/2012, (EU) No 600/2014 and (EU) No 909/2014. COM/2020/595 final.

cap and securities up to EUR 2,5 billion.[28] Lastly, those three regulations are accompanied by the Omnibus directive[29] amending existing legislation affected by the Digital Finance Package.

The Commission proposal brings up a definition of a crypto asset in Art. 2 as: *"a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology"*.[30] The proposal also classifies crypto assets and creates three categories with a different regulatory framework: (i) Asset-Referenced Tokens (ART), (ii) Electronic Money Tokens (EMT) and (iii) Crypto Assets other than ARTs or EMTs. Although the structure of the proposal follows those three categories, we can find a definition of "utility token" in Art. 3 (5) as a fourth type (iv), which represents a broad category, that could include also non-financial instruments (such as a tokenized ticket to the cinema or loyalty point on DLT).

The classification by the European Commission corresponds to the generally accepted taxonomy of tokens to (a) payment tokens, (b) security tokens and (c) utility tokens.[31] While the regulations cover payments tokens, (as stated above i – iii) and utility tokens (iv). By payment token, we usually understand an alternative to a fiat currency that can be used as a means of payment. Utility token then refers to a coin that can be exchanged for a good or service. Finally, we can talk about security tokens, which is tokenised (or digitalised) stock or bond, so the holder of this token is a shareholder.[32] The underlying assets is a financial instrument in this case.[33] Security tokens are not included in MiCA as they are covered by MiFID II[34]. Besides those three theoretical categories, 'stable coins' should be explained, however, European Commission does not use this term in the proposal. Both asset-referenced tokens and e-money tokens will probably be

[28] Proposal for a REGULATION of the European Parliament and of the Council on a Pilot Regime for market infrastructures based on Distributed Ledger Technology. COM/2020/594 final.

29 Proposal for a DIRECTIVE of the European Parliament and of the Council amending Directives 2006/43/EC, 2009/65/EC, 2009/138/EU, 2011/61/EU, EU/2013/36, 2014/65/EU, (EU) 2015/2366 and EU/2016/2341. COM(2020) 596 final.

[30] See the definition used by FAFT: *"a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities and other financial assets that are already covered elsewhere in the FATF Recommendations"*.

[31]MANDENG J. Ousmène. Basic principles for regulating crypto-assets. 2019. DOI:10.13140/RG.2.2.20547.86563. Available from: https://www.lse.ac.uk/iga/assets/documents/research-and-publications/OJM-Basic-principles-for-regulating-crypto-assets.pdf.

[32] PRAWA K. "Digital Asset Capital Market Law - A New Discipline of Private Law". Niezależne Studia Nad Prawem, Krytyka Prawa. Niezależne Studia nad Prawem, 13, no. 2 (2021): 195–208. doi:10.7206/kp.2080-1084.457.

[33] ALLEN G. J. et all. Legal and regulatory considerations for digital assets. Cambridge Centre for Alternative Finance, 2020. Available at: https://www.jbs.cam.ac.uk/wp-content/uploads/2020/10/2020-ccaf-legal-regulatory-considerations-report.pdf.

[34] DIRECTIVE 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

stable coins projects. The proposal on the contrary explicitly excludes non-fungible tokens from the scope of the regulation. MiCA further distinguishes "significant" ARTs or EMTs (stable coins). Significant stable coins are those with high market capitalisation, high trading volume. If a stable coin falls under the definition of a significant coin (ART or EMT) several special requirements will apply. For instance, a direct supervision by the European Banking Authority (EBA) is assumed.[35]

The general requirement for an issuer is a "white paper", which should include a description of the issuer and presentation of the project, the description of the underlying technology, offers to the public and all rights and obligations shall be described in detail. Also, a disclaimer of potential risks of losing value should be included. The aim is to protect the customer. The European Securities Markets Authority (ESMA) shall develop guidelines on the white paper. The white paper must be notified by the financial regulator. It means the requirement to send the paper in advance to the respective national competent authority, if not being prohibited it is automatically allowed. On the other hand, stable coins (EMTs and ARTs) should be evaluated and approved by the national competent authority.[36]

## 4. CRITICAL ANALYSIS OF THE PROPOSAL FOR A REGULATION ON MARKET IN CRYPTO ASSETS

The very first question concerning regulatory initiatives towards crypto is whether the regulation is needed. Together with the market growth, we can no longer talk about a niche market. Payment or investment use case of crypto assets may constitute direct competition to already regulated financial services.[37] Moreover, financial and capital markets typically follow detailed rules according to the specific services, such as payment services, electronic money, investment service etc. Keeping the regulatory gap between standard financial market and market in crypto assets by taking no legislative action would widen unfair competition and may increase risks for investors and even be the source of the illicit transactions. Private currencies initiatives by big technological corporations further underlined the need for rules. Regarding the role of competent market authorities[38], its calls

[35] SAULNIER, J. and GIUSTACCHINI I.: Digital finance: Emerging risks in crypto-assets – Regulatory and supervisory challenges in the area of financial services, institutions and markets, Study. European Parliament Research Service, 2020. DOI: 10.2861/525.

[36] See Article 5 of MiCA regulation.

[37] EBA. Report with advice for the European Commission. January 2019. Available at: https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2545547/67493daa-85a8-4429-aa91-e9a5ed880684/EBA%20Report%20on%20crypto%20assets.pdf?retry=1.

[38] Such as European Banking Authority and European Securites and Markets Authority in the EU, or alternatively Securities Exchange Commission in the U.S.

for regulations were inevitable. The popularity forced lawmakers to act. The strategy '*wait and see'* is no longer sustainable.[39]

Despite MiCA´s repeated stress on the principle of technological neutrality[40], the proposal shall in reality regulate the technology. Following the definition of crypto assets, the distributed ledger technology or similar technology represents a defining feature. Thus, the proposed definition covers both large crypto projects run on DLT and small iniciatives using DLT such as theatre tickets or loyalty points.[41] If such a wide definition is adopted, big market participants easily adapt regarding its access to funding, however, innovation by SMEs could be hindered as regulatory burden could be unbearable. I consider the definition problematic due to its scope to financial and non-financial crypto assets. Exceptions for non-financial projects run on DLT shall be considered by lawmakers as well.[42] Geographic adoption of crypto assets showed that its use is often driven to market dysfunction. Significant proliferation in Turkey, Vietnam or South American countries is driven by high inflation, distrust in the national currency or high banking fees for international transactions.[43] Covid-19 accelerated aggressive extensive monetary policy by Central banks. Scepticism towards monetary actions in developed countries in Europe or the United States favours crypto assets. Rising inflation may be a driver for escape from fiat currency to crypto assets. In addition, advancing technological solutions are making crypto assets more user friendly with applications on smart devices and centralised exchanges.

Although numerous amendments can be expected during the legislative process it should be stated that the framework based on the Commission's proposal seems to be outdated. For instance, standards for Initial Coin Offering (ICO)[44] represent a response to a market trend from 2017, which disappeared

[39] PAVLIDIS G. Europe in the digital age: regulating digital finance without suffocating innovation. Taylor and Francis Ltd. 2021.DOI: 10.1080/17579961.2021.1977222.

[40]See Legislative Financial Statement accompanying the proposal for regulation on market in crypto asseets. Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets and amending Directive (EU) 2019/1937. COM/2020/593 final.

[41] Under the current proposal running a digital ticket on blockchain would require issuing a white paper, fulling obligation for marketing comunication.

[42] The legislative sollution of establishing a list of exceptions of persons not falling under the definition has been discussed in the Coucil of the EU.

[43] CHAINANALYSIS. The 2021 Geography of Cryptocurrency Report. October 2021. Available at: https://go.chainalysis.com/rs/503-FAP-074/images/Geography-of-Cryptocurrency-2021.pdf

[44] Initial Coin Offering is specific fundraising system using tokens to collect funds in the initial phase of project development.

spontaneously. Second, the European Commission explicitly mentioned Facebook's project of Libra[45] [46] as a significant threat to the financial stability, however, given the rules from ART and EMT in the proposal, stable coins are perhaps the major target of the regulation.[47] On the other hand, the regulation ignores Decentralised Finance generally acknowledged as future direction on the market in crypto assets.[48] Finally, as the regulation shall be the framework, its position in the existing financial framework shall be specified during the legislative process. As the delineation between utility token under MiCA and security token under MiFID II is unclear.[49]

Regarding the primacy of MiCA in the crypto economy, the harsh criticism by stakeholders shall not be surprising. The proposal is the definitive move of crypto assets into the standard economy. If adopted without further changes as presented above the market would be continuously captured by large financial institutions.[50]

## 5. PERSPECTIVES OF THE REGULATION AND IMPLICATION FOR THE CZECH REPUBLIC

The Czech legal system has no complex legislation of crypto assets; however, crypto assets are subject to taxation. The General Financial Directorate provided an explanation in 2019 that crypto assets are subject to income tax.[51] Crypto assets services, such as mining pools, may be considered as a service that is subject to taxation[52]. We can find a reference to *"virtual assets*" two times in the Value Added Tax Act[53]: for the purpose of tax basis calculation and the liability of the recipient of the taxable performance. Czech Criminal law follows

[45] Later re-named to Diem.

[46] BUCKLEY Ross. Libra Project: Regulators Act on Global Stablecoins, in: Intereconomics - Review of European Economic Policy, Vol. 55, Number 6, pp. 392-398. November 2020. DOI:10.1007/s10272-020-0936-7.

[47] See art. 35 – 41 and art. 50 – 52 of MiCA regulation targeting significant ART and signicant EMT as global stable coin projects.

[48] WEF. Decentralized Finance (DeFi) Policy-Maker Toolkit. Whitepaper. June 2021. Available at: https://www3.weforum.org/docs/WEF_DeFi_Policy_Maker_Toolkit_2021.pdf.

49 ZETZSCHE Dirk A, ANNUNZIATA Filippo, ARNER Douglas W, BUCKLEY Ross P, The Markets in Crypto-Assets regulation (MiCA) and the EU digital finance strategy, Capital Markets Law Journal, Volume 16, Issue 2, April 2021, Pages 203–225, https://doi.org/10.1093/cmlj/kmab005.

[50] PRAWA K. "Digital Asset Capital Market Law - A New Discipline of Private Law". Niezależne Studia Nad Prawem, Krytyka Prawa. Niezależne Studia nad Prawem, 13, no. 2 (2021): 195–208. doi:10.7206/kp.2080-1084.457.

[51] GENERAL FINANCIAL DIRECTORATE. Obecný dotaz na kryptoměny, č.j.: 50 911/19/7100-10111-01399. GFŘ. 11 June 2019.

[52] TRNKOVÁ KOCOURKOVÁ, Hana and Michal HANYCH. Daně a kryptoměny. In: Bulletin Komory certifikovaných účetních. 2018, 19(2), p. 23.

[53] CZECH REPUBLIC. Act No 235/2004 Col., Value Added Tax Act [zákon č. 235/2004 Sb., o dani z přidané hodnoty].

AML/CFT standards in Act No. 253/2008 Col.[54] The Ministry of Finance of the Czech Republic published the public consultation[55] in 2018. During the Council of the EU negotiations, the Czech Republic repeatedly underlined that the aim of the regulation should be creating a legislative framework while following the principle of technological neutrality and asked for narrowing the scope. The final text should not in any case force small and medium entrepreneurs to leave the market. Finally, the Czech Republic did not support the supervision powers for the European Banking Authority and the European Securities and Markets Authority.

Looking at the private sector, we can identify a solid crypto community in the Czech Republic. For instance, the Czech Crypto Assets Association[56] strongly criticised the Commission's proposal. The main concerns come from strict requirements on crypto assets service providers, that may cause a significant increase in operational costs. The regulatory burden harming small businesses has been underlined. Blockchain4Europe highlighted the missing regulation of decentralised finance and asked for narrowing the scope only to crypto assets with financial purposes.[57] The Czech Republic is ranked as the first country worldwide in profit from crypto assets per capita[58]. An important global project has been developed in the Czech Republic, such as the first hardware wallet[59] or the first mining pool [60]. Nevertheless, stakeholders appreciated the aim of the creation of a framework "legalising" crypto assets.

MiCA regulation is going to be directly applicable in all EU Member States. The financial law in the Czech Republic reflects EU core financial regulation, such as MiFID II transposed in the Act No. 256/2004 Coll.[61], E-money directive transposed in the Act No. 370/2017 Coll.[62] As the Czech Republic lacks any framework for crypto assets, adoption of an implementing act of MiCA into

[54] CZECH REPUBLIC. Act No Act 253/2008 Col., on selected measures against legitimisation of proceeds of crime and financing of terrorism [zákon č. 235/2004 Sb., o některých opatřeních proti legalizaci výnosů z trestné činnosti a financování terorismu].

[55] MINISTRY OF FINANCE OF THE CZECH REPUBLIC. Veřejná konzultace – Blockchain, virtuální měny a aktiva. 30 November 2018. Available at: https://www.mfcr.cz/cs/soukromy-sektor/kapitalovy-trh/cenne-papiry/2018/verejna-konzultace-blockchain-virtualni-33613.

[56] CZECH CRYPTO CURRENCIES ASSOCIATIONS. ČKMA se vyhrazuje proti chystané evropské regulaci kryptoměnového trhu. Available at: https://www.ckma.cz/cs/blog/ckma-se-vyhrazuje-proti-chystane-evropske-regulaci-kryptomenoveho-trhu.

[57] BLOCKCHAIN 4 EUROPE. Regulatory Principles for Decentralised Finance (DeFi). June 2021. Available at: https://www.blockchain4europe.eu/news/.

[58] CHAINANALYSIS. The 2021 Geography of Cryptocurrency Report. October 2021. Available at: https://go.chainalysis.com/rs/503-FAP-074/images/Geography-of-Cryptocurrency-2021.pdf.

[59] *Trezor* was the first hardware wallet for secured storage of crypto assets.

[60] *SluchPool* was the first mining pool started its business in the Czech Republic. By mining pool we insterstand grouping stratégy of miners to increase profits from crypto assets mining.

[61] CZECH REPUBLIC. Act No Act 256/2004 Col., Capital Market Enterprising Act ('ZKPT') [zákon č. 235/2004 Sb., o podnikání na kapitálovém trhu (ZKPT)].

[62] CZECH REPUBLIC. Act No. 370/2017 Col, on Payments. [zákon č. 370/2017 Sb., o platebním styku].

Czech law may be a suitable legislative solution. Amendments to the Act No. 256/2004 Coll. and Act No. 370/2017 Coll. are expected. Because of the ongoing legislative procedure, the regulation is not expected to come into force before 2024 as significant disagreements during the trialogue negotiations about MiCA and DORA can cause a delay. The original proposal also includes the transitional period of 18 months. Thus, we can say that there are almost two years for the business to prepare for MiCA.

## CONCLUSION

Let us take crypto assets seriously - that may be a message from the market in 2020 and 2021. The dynamic development of this specific segment can be seen as a side effect of the pandemic. The EU has been working on legislation even before the pandemic. Attention to crypto assets forced a deeper look. The purchase of crypto assets by many institutional investors and the rising interest of retail investors caused by increasing prices urging regulators to create a suitable framework.

The ongoing tightening of anti-money laundering legislation aims to bring as much light as possible to the still dark and anonymous world of crypto transactions. The European Union set a plan to create a complex legislative framework that could become a global standard possibly later adopted by other jurisdictions. Harmonisation of the EU crypto market could be a real benefit that may push European crypto projects ahead. Although the proposal shows numerous areas that could disadvantage SMEs. The definition covers a wide range of activities including those that shall not be subject to the regulation. Concurrently, the proposal ignores the dynamically developing area of Decentralised Finance. It is clear from the proposal that the European Commission is trying to slow down initiatives of private coins by big tech companies. Apart from all criticism, the ambition of MiCA is to take crypto from the shadow economy, which is indisputably a positive fact, unfortunately, a rare one.

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# Crowdfunding credit services (peer to peer lending) in the light of the Proposal for a Directive of the European Parliament and of the Council on consumer credits

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***Abstract:*** *The paper identifies the most significant problems associated with the absence of regulation of peer to peer lending, where debtors are consumers. The paper evaluates identified problems from the perspective of the Proposal for a Directive of the European Parliament and of the Council on consumer credits released on June 30th, 2021. The paper considers mainly the selected aspects of draft regulation as: definitions, the legal regime of crowdfunding credit service providers, the assessment of consumer creditworthiness, information asymmetry and registration of crowdfunding credit service providers. The paper considers the selected issues from the point of view of European Union law and takes into account the specifics of the Slovak legislation due to the absence of studies focused on peer to peer lending at national levels. Based on this approach, the paper makes de lege ferenda proposals.*

***Keywords:*** *peer to peer lending, crowdfunding, consumer, lending.*

## INTRODUCTION

Crowdfunding credit services based on peer-to-peer lending are a new phenomenon in the fund lending segment and are becoming a significant competitor to consumer loan or housing loan services. Three stakeholders are involved in the peer-to-peer lending process, namely the debtor, the investor, and the provider of the internet platform through which the funds are rendered between the debtor and the investor. Peer-to-peer lending follows the crowdfunding idea, which is to raise funds from a large group of people, each of whom provides a relatively small amount of the total value. With peer-to-peer lending, instead of lending funds from a single source (a single creditor), the lender lends funds from a larger number of individuals—investors (multiple creditors). Scientific and expert arguments are underway on whether peer-to-peer lending is one of the types of crowdfunding, and both opinions are represented. We believe that the theoretical trend towards a complete separation of crowdfunding and peer-to-peer lending as two separate types of funding is due to the gradual successful establishment

of peer-to-peer lending as an extended lending model.[1]

The sharp increase in the popularity of peer-to-peer lending draws attention to the need for legislative changes to include these services.[2] This issue needs to be examined from the perspective of the European Union legislation, and at the same time, the laws of the Slovak Republic need to be taken into account due to the absence of studies aimed at peer-to-peer lending at national levels.[3] From the perspective of the European Union legislation it is important to mention i) Regulation 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 (the 'Crowdfunding Regulation') which regulates the peer to peer lending under which the debtor is not in the position of a consumer and ii) the Proposal for a Directive of the European Parliament and of the Council on consumer credits which regulates the peer to peer lending under which the debtor is a consumer. The Proposal for a Directive of the European Parliament and of the Council on consumer credits was released on June 30th, 2021.[4]

The newly adopted Crowdfunding Regulation regulated only the relations arising between peer-to-peer lending parties, under which the debtor does not include the definition of a consumer under Article 3 (a) of Directive 2008/48/EC of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (the 'Consumer Credit Directive'). The adoption of the Crowdfunding Regulation thus did not resolve the legal regulation of relationships arising within the framework of peer-to-peer lending, where a natural person—a non-entrepreneur—acts as a debtor. These relationships cannot be subsumed either under the legal regime of the Consumer Credit Directive (as the parties cannot be subsumed under the definition of a creditor-consumer relationship) or Directive 2014/17/EU of the European Parliament and of the Council of

[1] The opinion that peer to peer lending is a type of crowdfunding: ZIEGLER, Tania. Lending Crowdfunding: Principles and Market Development. In: Advances in Crowdfunding Research and Practice. Cham: Palgrave Macmillan, 2020, p. 62), (MAJEWSKI, Piotr. Crowdfunding: Characteristics and Typology. GOSPODARKA NARODOWA / The Polish Journal of Economics /. 2020, 301(1), pp. 139-150, (KUTI, Monika, and Gabor MADARÁSZ. Crowdfunding. Public Finance Quarterly. 2014, 59(3), p. 356), and BESTVINA BUKVIĆ, Ivana, and Iva BULJUBASIĆ. FINANCIAL AND MARKETING PERSPECTIVES OF A CROWDFUNDING. In: Economic and Social Development, 26th International Scientific Conference on Economic and Social Development – "Building Resilient Society". 2017, pp. 353-364). An opinion on the impossibility of subsuming peer to peer lending under crowdfunding can be found in the Evaluation of the Mortgage Credit Directive (Directive 2014/17 / EU) Final Report, p. 100.

[2] HAVRYLCHYK, Olena, et al. The Expansion of Peer-to-Peer Lending. Review of Network Economics. 2021, 19(3), pp. 145-187.

[3] Available studies concerning peer to peer lending mainly concentrate on China and USA See e.g. ZIEGLER, Tania. Lending Crowdfunding: Principles and Market Development. In: Advances in Crowdfunding Research and Practice. Cham: Palgrave Macmillan, 2020, p. 87.

[4] The draft is in ongoing legislative procedure.

4 February 2014 on credit agreements for consumers relating to residential immovable property (the 'Home Loan Directive').

The provision of peer-to-peer loans in a manner were

(i) the creditor is a natural person (non-entrepreneur),

(ii) a debtor is a natural person (non-entrepreneur), and the loan is rendered through a peer-to-peer lending platform remains unregulated, and the legislative framework is up to the individual states. No legal regulation currently exists in the Slovak Republic that could apply to this segment.

Based on our previous research, we have identified the following most significant issues associated with the non-existence of legislative regulation to this type of peer-to-peer lending. The issues were identified in terms of

(i) the existing legislative framework governing consumer credits and home loans,

(ii) efforts to reduce household indebtedness vis-a-vis the normative powers of the Národná banka Slovenska (National Bank of Slovakia (the 'NBS')),

(iii) legal relationships arising between individual peer-to-peer entities (the debtor/investor and peer-to-peer lending platform provider relationship, debtor and investor relationship when providing a loan), as well vis-a-vis the decisions of Slovak courts.

We believe that the key issues of non-regulation include:

- Disruption of the consumer credit rating system, as data on peer-to-peer lending are not entered into the credit database. Reciprocally, peer-to-peer lending platform providers are at a disadvantage in accessing these databases to assess the creditworthiness of the consumer.

- Distortion of efforts to reduce household indebtedness, which is due to the lack of a legislative framework for assessing consumer creditworthiness for peer-to-peer lending. This fact also has a negative effect on the protection of the customer from the perspective of their over-indebtedness and the performance of security institutions for loan default situations. Household over-indebtedness can be caused by unforeseen life situations, but also by irresponsible ways of money drawing and lending.[5] Economic changes increase the risk associated with household over-indebtedness. According to a survey conducted at the EU level at the end of 2020, six out of ten consumers have had financial problems since the beginning of the pandemic and about four out of ten reported a difficult financial situation.[6]

[5] COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT REPORT Accompanying the Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on consumer credits {COM(2021) 347 final} - {SEC(2021) 281 final} - SWD(2021) 171 final.

[6] Survey conducted by Kantar for the European Parliament, November 2020. https://ec.europa.eu/info/sites/info/files/future_financial_concerns_-_country_distribution_0.pdf. For a comprehensive view, it is also necessary to take into account the indebtedness of the corporate sector. (ÚRADNÍK, Michal. Zvyšovanie úverových kapacít bánk-opatrenie na podporu ekonomiky

- The absence of investor protection, especially with an emphasis on the position of the investor in peer-to-peer lending, where the investor acts as a natural person (non-entrepreneur).

- The absence of provisions aimed at protecting the consumer as a debtor, the right to withdraw from the agreement without giving a reason, the creditor's duty to disclose information, the annual cost of a loan to a borrower **(**APR), early repayment fee amount, the right to defer payments in connection with the COVID-19 pandemic.[7]

- Legal uncertainty for peer-to-peer lending platform providers due to the existence of divergent national regulations and obstacles to their cross-border engagement.

- Legislative vacuum on products used to co-finance the purchase of the real estate.

- The issue connected with the actual administration of existing agreement if a peer-to-peer lending platform is terminated as a result of the anonymity of the parties and the high number of parties on either the debtor side or the investor side (the identity of the investor is often unknown to the debtor, when the peer-to-peer lending platform provider acts on behalf of the investor).[8]

The originally announced benefits of peer-to-peer lending, which included the speed of loan granting, the opportunity to get a loan for consumers with low creditworthiness under the legislation, ultimately became the main reasons for regulation.[9]

## 1. DRAFT CONSUMER CREDIT DIRECTIVE

The legislative vacuum is addressed by the the Proposal for a Directive of the European Parliament and of the Council on consumer creditsof 30 June 2021 (the 'Draft'), which extends the applicability of the directive to peer-to-peer lending credit services. The Draft leaves the statutory construction based on the definition of a credit agreement as an agreement whereby the creditor grants or promises to grant credit to the consumer. The Draft also leaves the definition of

alebo opatrenie narušujúce finančnú stabilitu pro futuro. In: Právo v podnikání vybraných členských států Evropské unie. Sborník příspěvků k XII. Ročníku mezinárodní vědecké konference. Praha: TROAS, s.r.o., 2020, pp. 375–381,).

[7] DOLÍHALOVÁ, Miroslava. Odklad splátok počas trvania pandémie-cesta k následnému posilneniu zabezpečovacích inštitútov? In: Právo v podnikání vybraných členských států Evropské unie. Sborník příspěvků k XII. Ročníku mezinárodní vědecké konference. Praha: TROAS, s.r.o., 2020, pp. 349–356.

[8] This is based on the very nature of peer to peer lending, where one investor invests in a larger number of loans and, conversely, a loan from one borrower is financed by a larger number of investors.

[9] MILNE, Alistair, and Paul PARBOTEEAH. The Business Models and Economics of Peer-to-Peer Lending. Brussel: European Credit Research Institute, 2016, p. 4, and FERRETTI, Federico. Peer-to-Peer Lending and EU Credit Laws: A Creditworthiness Assessment, Credit-Risk Analysis or … Neither of the Two? German Law Journal. 2021, 22(1), p. 105.

creditor, consumer, and credit intermediary intact. With regard to the material examined, it is important to note that the defining feature of the creditor is the provision of credit within its business or entrepreneurial activity and the defining feature of the consumer is the conduct that is unrelated to their business or entrepreneurial activity. The credit intermediary actions are to match the interests of the debtor and the creditor.[10] The position of creditor, consumer, and credit intermediary defined this way responds to the impossibility of subsuming peer-to-peer lending, where a natural person (non-entrepreneur) acts as a debtor and an investor under the regime of the applicable Consumer Credit Directive and at the same time justifies the new stipulation of the regime for crowdfunding credit service providers.[11]

The legal regime of crowdfunding credit service providers (the 'Crowdfunding Provider') is—under the Draft—subdivided into three categories, which are covered by a differently defined framework of obligations. These categories follow different scenarios for the possible operation of peer-to-peer lending:

i) The Crowdfunding Provider operates a digital platform and provides credit directly to consumers. We believe that this alternative would be possible even with the so-called balance sheet lending.[12] In this case, all provisions that apply to creditors apply directly to Crowdfunding Providers. It should be noted here that even under current legislation, a credit service provider should have a license in such a case to provide credit to customers.[13]

ii) The Crowdfunding Provider facilitates the provision of credit between creditors, who perform these services in the course of their trade, business or profession, for a fee, and consumers. The obligation of creditors under the Draft apply to creditors who provide credit. Crowdfunding Providers shall be bound by the obligations of credit intermediaries under the Draft.

iii) The Crowdfunding Provider facilitates the provision of credit between persons who do not provide these services in the course of their trade, business or profession, for a fee, on one hand, and consumers on the other. In this case, these are peer-to-peer lending platforms whose entry requirements directly stipulate that the investor must be a natural person (non-entrepreneur) and the debtor a natural person (non-entrepreneur).[14] The fact that such investors cannot be construed as creditors under the Draft, they are not bound by the obligations

[10] Article 3 of the Proposal for a Directive of the European Parliament and of the Council on consumer credits.

[11] MACCHIAVELLO, Eugenia. The European Crowdfunding Service Providers Regulation: The Future of Marketplace Lending and Investing in Europe and the 'Crowdfunding Nature' Dilemma. European Business Law Review. 2021, 32(3), 557–608.

[12] BANK FOR INTERNATIONAL SETTLEMENTS & FINANCIAL STABILITY BOARD. *Market Structure, Business Models and Financial Stability Implications Bank for International Settlements*. 2017, p. 15 Available at https://www.bis.org/publ/cgfs_fsb1.pdf.

[13] For example, Benxy s.r.o., which operates the Zonky peer-to-peer platform, c.z. in the Czech Republic.

[14] In the conditions of the Slovak Republic, e.g. Žltý melon.

that the Draft imposes on creditors. Only some obligations apply to Crowdfunding Providers stipulated in the Draft.[15]

We believe that the last alternative represents one of the most important types of peer-to-peer lending that lead to the need for regulation, especially vis-a-vis the position of investors and consumers as natural persons (non-entrepreneurs) and the inability to subsume such a relationship under regulatory models. At the same time, this peer-to-peer lending model requires sensitive regulation of rights and obligations due to the specific position of the parties involved. We positively regard the efforts to regulate this type of peer-to-peer lending.

## 2. DRAFT APPLICATION TO THE ISSUES IDENTIFIED

Following the identification of issues connected with the absence of regulation of peer-to-peer lending, we positively regard the following legislative steps of the legislator stipulated in the Draft.

One of the key duties—around which the Draft is produced—is an adequate assessment of consumer creditworthiness to avoid household over-indebtedness. The Draft maintains the same approach to the obligation to assess the consumer's creditworthiness, namely the creditor's duty to provide credit to the consumer only if the creditworthiness assessment indicates that the consumer is likely to be able to meet their contractual duties

In addition to creditors, the obligation to assess the creditworthiness of consumers extends to the Crowdfunding Provider, who facilitates the provision of credit between natural persons (non-entrepreneurs), i.e. if the investor is not providing credit in the course of their trade, business or profession. Creditors and Crowdfunding Providers have the duty to introduce procedures for conducting creditworthiness assessments and keep records and maintain these procedures. Following the extension of the obligation to assess the creditworthiness of consumers to Crowdfunding Providers, they are also given access to databases for creditworthiness assessment purposes.[16]

We regard this step positively for several reasons:

(i) it has a positive effect on consumer protection in terms of the risk of over-indebtedness and adverse aspects associated therewith,

(ii) it harmonizes the legal status of Crowdfunding Providers and provides them with a tool to be able to assess consumer creditworthiness, and

(iii) it partially reduces the risk on the investor side. This is especially important in peer-to-peer lending models, where investors are natural persons (non-entrepreneurs), who bear all the risk of loss associated with credit defaults but who have no power to influence the creditworthiness assessment process or

[15] Article 2 of the Proposal for a Directive of the European Parliament and of the Council on consumer credits.

[16] Chapter IV of the Proposal for a Directive of the European Parliament and of the Council on consumer credits.

even have no access to sufficient information on the soundness of the creditworthiness assessment process, which at the same time increases the information asymmetry on the part of the investor associated with the degree of risk and the rate of potential return.[17]

From the perspective of assessing the creditworthiness of the consumer, emphasis is also placed on the mitigation of the human factor risk on the part of the creditor with automated processing and consumer profiling.[18] Member States are left with the possibility to issue additional guidelines on other criteria and methods for assessing consumer creditworthiness, such as setting loan-to-value ratio or loan-to-income ratio limits.[19]

In addition to assessing consumer creditworthiness, the Draft also follows on the reduction of information asymmetry through disclosure obligations imposed on creditors as well as on Crowdfunding Providers. Due to the close correlation between information asymmetry and financial literacy, the Draft assigns the duty to increase financial literacy to the Member States, which should play an active role in increasing financial literacy.[20] Crowdfunding Providers are also bound by the duty to disclose information before the agreement is made, and the consumers retain the right to withdraw from the agreement.[21]

The Draft included Crowdfunding Providers under the authorization scheme together with other creditors and credit intermediaries conceptually. Consequently, Crowdfunding Providers fall under the authorization scheme notwithstanding whether they act as creditors (participating themselves in lending), as intermediaries (among creditors who provide consumer credits as part of their business), or merely as peer-to-peer lending platform providers who match the interests of investors (who do not provide consumer credits as part of their business) and debtors (consumers). We regard this step positively in relation to conceptual unity also, increasing legal certainty for peer-to-peer lending parties and

[17] FERRETTI, Federico. Peer-to-Peer Lending and EU Credit Laws: A Creditworthiness Assessment, Credit-Risk Analysis or … Neither of the Two? German Law Journal. 2021, 22(1), p. 121.

[18] Article 18 of the Proposal for a Directive of the European Parliament and of the Council on consumer credits released on June 30th, 2021.

[19] In the conditions of the Slovak Republic, the system of assessing the creditworthiness of the consumer is set quite precisely in response to the increasing indebtedness of households, which includes Maximum maturity of loan, - Debt service-to-income (DSTI) ratio, Debt-to-income (DTI) ratio. Decree of Národná banka Slovenska of 13 December 2016 No 10/2016 laying down detailed provisions on the assessment of borrowers' ability to repay housing loans.

[20] HAN, Jae-Joon, and Wonchang JANG. Information Asymmetry and the Financial Consumer Protection Policy. Asian Journal of Political Science. 2013, 21(3), p. 213, and KORONCZIOVÁ, Andrea. Problematika finančného vzdelávania v spojitosti s finančno-právnym vzdelávaním. In: Aktuálne otázky finančného práva a trendy v jeho výučbe. Bratislava: Univerzita Komenského, Právnická fakulta, 2016, pp. 62-63.

[21] Article 21, and Article 26 of the Proposal for a Directive of the European Parliament and of the Council on consumer credits.

supporting the development of the internal market.[22]

However, what we regard to be a significant shortcoming is the fact that the Draft stipulates no safeguarding measures if a failure occurs on the part of the Crowdfunding Provider. In this regard, we see the possibility of being inspired by the Crowdfunding Regulation, which stipulates the duty to attach to the application for authorization the applicant's business continuity plan, including measures and procedures to ensure continuity of critical functions to mitigate the adverse effects of peer-to-peer lending services potential default concerning existing investments and the sound management of agreements between the peer-to-peer lending service provider and their clients. A plan to ensure the continuity of the management of the existing agreements is particularly essential, as the identity of the investor and debtor is often hidden in practice (the Crowdfunding Providers acts on behalf of the investor), and thus the actual administration of agreements is more than compromised if the Crowdfunding Provider is in default without a contingency plan. This problem is exacerbated by the very nature of peer-to-peer lending (more people are on the side of both investors and creditors).

The Draft waives the duty of Crowdfunding Providers to have special procedures in place to adequately adjust the repayment terms for consumers before recovery proceedings take place and imposes this duty on the investors only (i.e. including those Crowdfunding Providers who act as creditors). It is understandable why the legislator took this approach, as the Crowdfunding Provider is not legally a creditor of the claim (if it were, it would also hold the position of a creditor under the Draft). On the other hand, in practice, framework cooperative agreements between an investor and a Crowdfunding Provider directly stipulate an assignment clause of claims for cases of default to another person designated by them. In addition, the administration of agreements before the moment of default, as well as any related steps therewith (e.g. creditor announcement of early loan repayment) fall under the contractually conditioned activity of the Crowdfunding Provider, and in practice, they are an integral part of the Crowdfunding Provider operation. For this reason, we believe that to achieve comprehensive and non-discriminatory consumer protection, it is necessary to extend this duty to Crowdfunding Providers.

## CONCLUSION

The new legislation coming up in the form of the Draft brings solutions to the majority of the identified issues stemming from the absence of harmonized regulation. The differentiation of the legislative approach to individual Crowdfunding Providers covers a wide range of possible alternatives in the operation of peer-to-peer lending while maintaining the statutory construction of the current Consumer Credit Directive based on the definition of creditor, debtor, and credit

[22] Article 37 of the Proposal for a Directive of the European Parliament and of the Council on consumer credits.

intermediary, and the defining elements of a credit agreement. The inclusion of peer-to-peer lending platforms, whereby natural persons act as debtors and investors outside the course of their trade, business or profession, can be regarded positively. We believe that this type of platform is the most important in terms of regulatory needs. The Draft appropriately covers most of the issues related to the obligations of Crowdfunding Providers and the protection of debtors acting as consumers. We regard the absence of a stipulation of a Crowdfunding Provider plan to ensure business continuity as a significant shortcoming, where we see the risk in case of Crowdfunding Provider default with regard to the actual administration of the existing agreements, which we believe should be addressed by applying provisions of the Crowdfunding Regulation mutatis mutandis. Among the key areas that remain unresolved is the provision of legal protection to investors, who in this case, are natural persons (non-entrepreneurs) and hold a weaker position in terms of information asymmetry, while bearing the full risk in case of loan default. We believe that, as is the case of consumer (debtor) protection, adequate protection will be needed in this case as well, which will grow in importance along with the growing popularity of peer-to-peer lending.

We believe that the following issues are among the topics that need to be further investigated: The issue of the internal organization of the operation of Crowdfunding Providers who act as creditors providing these services in the course of their business and the application of the relevant Draft stipulations to such provisions of crowdfunding services. In this case, the obligation to assess the creditworthiness of the consumer should apply to these creditors, which partially undermines the idea and in particular the benefit of using the services of a Crowdfunding Provider whose profit comes from facilitating lending including assessing consumer creditworthiness and agreement administration. In addition, it is also needed to address the legislative vacuum for products where Crowdfunding Providers offer products aimed at co-financing the purchase of the real estate. This type of product responds to the fact that financing for a housing loan is not provided in the full amount of the value of its collateral (real estate prices). In Slovak practice, peer-to-peer lending platforms offer a loan for co-financing the purchase of the real estate, which is secured by a lien on real estate, and this lien is not registered with the real estate registry office. It is registered only if a loan default occurs. In this regard, it is necessary to deal with the legal regime of this type of product. We believe that it will be necessary to cover Crowdfunding Providers for home loans too.[23]

[23] Review of the Directive 2014/17/EU of the European Parliament and of the Council on credit agreements for consumers relating to residential immovable property. COM(2021)229 – Report.

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# Beneficial ownership regulation: Slovakia and selected countries

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***Abstract:*** *In recent years, especially within the European Union, Anti-money Laundering (AML) legislation has intervened in business law and introduced significant regulatory obligations in the area of registration of beneficial owners of companies. Although this regulation in the EU member states is based on the EU directives law, there is a relatively wide scope for its implementation and individual member states use different mechanisms of its operation, verification of data or sanctions. Slovakia differs from other countries in that there is a double regulation of beneficial owners for two different purposes. In this paper, we analyse the legislation and practice in the regulation of beneficial ownership in selected countries and describe our findings regarding the similarities and differences of individual models. In our research, we also focus on the possibility of implementing innovative regulation models in the Slovak Republic, where two different legal regulations are not addressed in an effective manner.*

***Keywords:*** *beneficial ownership, AML directives, register of beneficial owners, corporate structure transparency, company ownership.*

## INTRODUCTION

The issue of regulation of beneficial owners of companies has been developing relatively dynamically in recent years, as in particular, the European Union ("EU") directives set the trend in this area that the Member States must follow and other countries in the world are inspired by.[1] Of course, the goal of beneficial owners regulation is to combat money laundering and terrorist financing ("AML"), a global problem that requires global solutions.[2] Within the EU, this area is regulated in particular by the 4th and 5th AML Directives.[3] The 4th AML Directive requires all EU Member States to introduce into their national law provisions requiring legal persons to obtain and maintain adequate, accurate, and up-to-date information on their beneficial owners, including details about the

[1] This paper is an output in a project granted by Slovak Research and Development Agency, under Grant APVV-17-0641: Improvement of effectiveness of legal regulation of public procurement within EU law context.

[2] DA SILVA, Bruno. EVOLUTION OF THE BENEFICIAL OWNERSHIP CONCEPT: MORE THAN HALF OF CENTURY OF UNCERTAINTY AND WHAT HISTORY CAN TELL US. *Frontiers of Law in China*. 2017, 12(4), 501–523. ISSN 1673-3428 / 1673-35.

[3] GILMOUR, Paul Michael. Lifting the veil on beneficial ownership. *Journal of Money Laundering Control*. 2020, **23**(4), 717–734. ISSN 1368-5201. Available from: doi:10.1108/jmlc-02-2020-0014.

share size.[4] According to the Directive, this information is to be collected in one of the central registers of a Member State, for example in the commercial register. For the purposes of this Directive, the need for accurate and up-to-date information on the beneficial owners is a key factor in the investigation of offenders who might otherwise hide their identities behind a corporate structure. Access to the data collected was to be provided to authorities and bodies involved in the fight against money laundering, terrorist financing and related crimes.

On January 10, 2020, the EU´s 5th AML Directive[5] entered into force and although the most fundamental changes introduced by this Directive deal with the regulation of cryptocurrencies, it also partially affects the obligation to register beneficial owners. Under this Directive, Member States should ensure that information on beneficial owners of companies is made available to anyone in the general public.[6] This means that the Member States must take steps to ensure that data on beneficial owners, previously available only to authorities operating in criminal proceedings, are published, and made available to the public.

The aforementioned public law regulation also interferes with private law and law in business, as it brings new obligations especially for subjects of private law - legal entities. However, the AML Directives are relatively vague in defining how the Member States should set up national regulation (e.g., registration process, beneficial owners identification, sanctions for breaches, etc.), leaving the Member States ample scope to set up their own, unique registration and verification mechanisms.[7] In this respect, therefore, a comparison of the different beneficial ownership registration rules can be inspiring for the legislator. For this reason, we performed an analysis of AML regulations in EU member states and selected several of them for closer presentation, either due to their proximity to the Slovak legal system or due to the use of innovative methods of registration of beneficial owners or effective ways of sanctioning false entries in the register. We developed this research as part of the study of public procurement law in Slovakia and as we will show in more detail in the next section, Slovakia introduced a unique regulation of beneficial owners registration, precisely for state spending, which in many ways overlaps with AML regulation but does not fully use its potential.

[4] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC („4th AML Directive"), Art. 30(1).

[5] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directives 2009/138/EC and 2013/36/EU („5th AML Directive").

[6] 5th AML Directive, Art. 1(15).

[7] JASPER, Korving. Beneficial Ownership Interpreted, To What Extent Are the OECD and the EU on the Same Wavelength? *Intertax*. 2021, 49(3), 254–277. ISSN 0165-2826.

## 1. BENEFICIAL OWNERSHIP REGISTRATION IN SLOVAKIA

As we have already mentioned, Slovakia is unique in the world in that it has two regulations of beneficial ownership, each serving a different purpose. The first of them is the legal regulation of the so-called Register of Public Sector Partners ("RPSP") and the second is the standard regulation in the sense of the AML directives.

### 1.1. Register of Public Sector Partners

Due to its extent, we do not present the exhaustive social context of the adoption of the RPSP Act, but for the purpose of this paper, we can say that the gradual development has led the public to require that private-sector contractors of state should publish their beneficial owners in a public, open register. Act no. 315/2016 Coll. on the Register of Public Sector Partners and Amendments to Certain Acts was approved by the National Council of the Slovak Republic in October 2016 and entered into force on 1 February 2017. The basic mechanism of application of this law assumes that a company that wants to obtain performance from the state, in a certain minimum amount, is obliged to register its beneficial owner in the RPSP and subsequently public sector entities may enter into various legal relationships with it.

If a company does not fulfil this obligation, public sector entities may not enter into contractual relations with it and if they are in a specific contractual relationship with such a company, they have the right to withdraw from it.[8] To ensure the registration of the beneficial owner in the register, a completely new entity appears here - an authorized person who performs a specific, statutory profession[9], based on which it is able (and obliged) to proceed with the identification of the beneficial owner with professional care. Identification of the beneficial owner is not a one-off act, the authorized person will always perform it at the verification event and regularly as of 31 December.[10] A very important mechanism for data verification is proceedings before the registry court and the possible sanctions that both the public sector partner and the authorized person face when providing false or incomplete data. Failure to provide true and complete information about the beneficial owner or failure to notify a change in the beneficial owner´s structure within 60 days can result in a fine of up to EUR 1,000,000.

In addition to sanctioning the company, a fine may be imposed for breach

[8] Act No. 343/2015 Coll. Act on Public Procurement and on the Alteration and Amendment of Some Acts, para 19(3).

[9] Advocate, Notary, Tax advisor and Bank.

[10] LUKACKA, Peter, and Filip PETREK. Register partnerov verejného sektora a súvisiace povinnosti uchádzačov vo verejnom obstarávaní. *Acta Facultatis Iuridicae Universitatis Comenianae*. 2019, (1), 50–66.

of these obligations directly on the statutory body, up to the amount of EUR 100,000. At the same time, an authorized person is a guarantor for the payment of the fine imposed on the statutory body.[11] The registering authority shall impose a fine of between EUR 10,000 and EUR 100,000 on the authorized person if it violates the requirement of impartiality and the court proves that it was in some way connected with a public sector partner.[12]

### 1.2. Registration of beneficial owners in Slovakia on the purpose of AML

The RPSP Act undoubtedly regulates an area that is very close to the AML legislation, however, the adoption of this Act did not transpose the 4th AML Directive, due to the narrow and specifically selected scope of companies registered in the RPSP. The directive in question was later transposed and as of 1 November 2018, this regulation introduced in Slovakia the obligation to enter in the Commercial Register identification data of the beneficial owners of legal entities that are not public entities. Sanctions are also associated with the entry in the Commercial Register, the court will impose a fine of up to EUR 3,310 on a company that has not complied with the obligation to register the beneficial owner or if it has provided false information.[13] The sanctions that the law allows to be imposed for violation of this obligation are therefore significantly lower than in the case of RPSP, from which we can deduce the difference in the importance that the state attaches to these two obligations.

The 5th AML Directive was transposed into Slovak law in late 2020. The solution of publishing data on beneficial owners, as the Directive requires this data to be public, is relatively strange. Despite these data being registered in the Commercial Register, they are not published in this register, but the public can access them through the Register of Legal Entities, where free online access is possible only through the website of the Statistical Office of the Slovak Republic, which is quite confusing. At the same time, the legislator had to resolve the duplication of beneficial ownership registration for those companies that have already fulfilled the registration obligation by registering in the RPSP. For the sake of certainty, the Commercial Register Act stipulates that the registration of a beneficial owner in the commercial register does not replace the obligation to register a public sector partner in the RPSP.[14] Conversely, however, an entity that is reg-

[11] Act on Public Procurement, *supra note 4*, para. 13.
[12] KRŠJAKOVÁ, Zuzana. Sanction mechanism of the register of public sector partners in context of public procurement. *Bratislava Law Review*. 2019, **3**(2), 18–33. ISSN 2644-6359. Available from: doi:10.46282/blr.2019.3.2.143
[13] Act no. 530/2003 Coll. on the Commercial Register as amended, para. 11(1), (2).
[14] *Id.*, para. 2(3).

istered in the RPSP is not obliged to register the beneficial owners in the Commercial Register.[15] As registration in the RPSP is subject to stricter conditions and the identification of the beneficial owners is ensured by an authorized person, it is justified that the State prefers this method of registration.

## 2. REGISTRATION OBLIGATION OF BENEFICIAL OWNERS IN SELECTED COUNTRIES

When examining the legal regulations of the registration obligation in terms of AML regulations, we focused on the EU Member States due to the same legal basis in the directive law, and because of the proximity of legal orders. In a broader context, it is possible to address other countries where there is similar AML regulation, such as the United Kingdom, the United States or Switzerland, but currently, the EU as a whole has this regulation at the most advanced level.

### 2.1. Czech Republic

The Czech Republic and its legal system are very close to Slovakia, due to its common history and similar language, which is why its legal order is a very frequent source of inspiration for the legislator in Slovakia. The legislator here has chosen a separate legal regulation in Act no. 37/2021 Sb. on the register of beneficial owners, which entered into force on 1 June 2021. As in Slovakia, the Czech Republic has a limit of 25 % share or benefit in the company to meet the definition of a beneficial owner, but unless it can be determined in this way, a person in the top management of the corporation is considered the beneficial owner.[16]

However, there is an interesting difference from the Slovak definition - if such a company, in which it was not possible to identify a beneficial owner, is owned by another company, then members of the statutory body of this parent company will be registered as beneficial owners.[17] For comparison, in Slovakia, it is members of the statutory body of the registered company, not its parent company, that is undoubtedly closer to the meaning of the beneficial owner.[18] The law also brought substantial changes in line with the requirements of the directive. For example, some information about the beneficial owner in the register will be available to the public and the law will also introduce sanctions.[19] The current practice in the Czech Republic in entering the real owner in the register is such

[15] *Id.*
[16] Act no. 37/2021 Sb. on the register of beneficial owners, para. 5(1).
[17] *Id.*, para. 5(2).
18 LEONTIEV, Andrej, and Marek ANDERLE. Register konečných užívateľov výhod – stop pre schránkové firmy vo verejnom obstarávaní? *Bulletin Slovenskej advokácie*. 2017, 2017(1-2), 6–14. ISSN 1335-1079.
[19] *Id.*, para. 14(1).

that the basis for their registration is mainly a solemn declaration of the company, which describes its ownership structure, the new law gives an indicative listing of corporate documents by which the company may prove the real owner. The solemn declaration will be used only in cases where it is not possible to prove the ownership relationship in any other way.[20]

Sanctions for breach of the obligation to register the beneficial owner are defined as public, which is a fine of up to EUR 19,345 (calculated) for the company and also for the beneficial owner, who did not provide the necessary cooperation, and private law sanctions, which affect the beneficial owner not recorded in the registry. For example, a ban on the payment of business profits to such an owner or a ban on the exercise of their voting rights at the general meeting, even if they are the sole shareholder.[21] In particular, the delimitation of private law sanctions is innovative, and it will be interesting to monitor their application in practice.

### 2.2. Kingdom of Denmark

Denmark was the first Member State to adopt the necessary national regulation, while the other Member States were inspired by it in some respects.[22] In Denmark, the obligation to register beneficial owners is effective from 1 December 2017, the body in charge of managing the register is the Danish Business Authority, which also manages the commercial register, as the final ownership information is part of the commercial register.[23] Beneficial ownership information is publicly available to the extent of the name, address and legal title of the owner. The company must then check at least once a year that the information on beneficial ownership is correct and up-to-date, and the results of the review will be presented at a meeting where the general meeting approves the annual report. The company is also obliged to keep information about its beneficial owners for a period of 5 years after the identification. If the company does not register information or the data is out of date or incorrect, it may be fined.[24] The Danish Business Authority may also impose a liquidation order as a sanction if the company has not registered the beneficial owner or the registration is incomplete or

[20] PARNAIOVÁ, Alexandra. Nový zákon o evidenci skutečných majitelů vstupuje v účinnost již 1. 6. 2021 | HAVEL & PARTNERS. [online]. [no date] [viewed 4 October 2021]. Available from: https://www.havelpartners.cz/zakon-o-evidenci-skutecnych-majitelu-vstupuje-v-ucinnost.

[21] Act no. 37/2021 Sb. on the register of beneficial owners, para. 52.

[22] DE PIETRO, Carla. Beneficial Ownership, Tax Abuse and Legal Pluralism: An Analysis in Light of the CJEU's Judgment Concerning the Danish Cases on Interest. *Intertax*. 2020, 48(12), 1075–1086. ISSN 0165-2826.

[23] Beneficial owners. *Danish Business Authority* [online]. [viewed 4 October 2021]. Available from: https://danishbusinessauthority.dk/beneficial-owners.

[24] Guidelines for registration of beneficial owners. *Danish Business Authority* [online]. [viewed 4 October 2021]. Available from: https://erhvervsstyrelsen.dk/vejledning-reelle-ejere.

misleading.[25]

However, what is interesting from the point of verification of entries in the register is the dual approach based on whether the beneficial owner is registered under the country's social security system. If so, the information system, after registering a person, will automatically check in the databases of the Central Population Register the address at which the person has a permanent residence (if any), whether it is a living person and not kept as missing.[26]

A different procedure is chosen if the registered beneficial owner does not have Danish citizenship or a social security number. In this case, data from central databases are not available and the Danish Business Authority has chosen a series of control steps to verify the existence of the person and their correct address. First, it verifies in international databases whether the registered address of residence actually exists, and then sends a letter to this address informing the person that they have been registered in the Danish commercial register. If the letter is returned to the Office due to an incorrect address or unknown addressee, the company that registered the person will be asked to provide the correct address or other business documents.[27] To verify the identity of a foreign beneficial owner, the Danish Trade Authority requires a photograph of their passport or ID of the EU Member State citizen. The Office then carries out a more detailed inspection of those companies that appear to be risky or for some reason problematic. Companies that do not prove the truth of their registration in the proceedings before the Office can subsequently be sent to liquidation, by October 2020, up to 17 orders to initiate liquidation were issued through this procedure.[28]

### 2.3. Romania

An interesting example is Romania, where the register of beneficial owners was introduced only in 2019.[29] The scope of the data recorded is in principle the same as for the other Member States mentioned, and the registered data are also part of the commercial register here, but a slightly different procedure has been applied to the data registration process. The basis here was an affidavit of

[25] EU Transparency Registers. *Dentons Publisher* [online]. [viewed 4 October 2021]. Available from: https://publisher.dentons.com/experience/eu-transparency-registers.

[26] BERTELSEN, Jesper. How Denmark is verifying beneficial ownership information - Tax Justice Network. *Tax Justice Network* [online]. 8 October 2020 [viewed 4 October 2021]. Available from: https://www.taxjustice.net/2020/10/08/how-denmark-is-verifying-beneficial-ownership-information.

[27] *Id.*

[28] *Id.*

[29] BEDROS, Luiza. Romania: The 4th AML Directive finally transposed into domestic legislation - Noerr. *Führende Europäische Kanzlei - Noerr* [online]. 13 August 2019 [viewed 5 October 2021]. Available from: https://www.noerr.com/en/newsroom/news/romania-the-4th-aml-directive-finally-transposed-into-domestic-legislation.

the company, which had to be verified. The verification under the law was a certification by a notary, attorney, or signing in person at the registry court by the company representative.[30] The obligation of regular identification of the beneficial owners in certain verification events was also applied here. Such as event was the change of data on the beneficial owner and also annually within 15 days from the approval of the financial statements.[31] In the course of 2020, however, there was a significant simplification of the administrative complexity of registering data on the beneficial owners. Based on statistics from the Romanian Commercial Register, more than 95% of limited liability companies in the country were established as single-member companies, and the legislator decided to simplify the registration for these companies. Currently, the Commercial Register automatically registers a single shareholder as a beneficial owner, unless the company files another person.[32] This law also removed the annual verification of beneficial ownership. Sanctions in Romania for providing false or incomplete information are punishable by law by a fine of up to € 2,200, and if the entity does not provide complete and true information after the fine has been imposed, the court may order the liquidation of the company.

### 2.4. Other selected EU member states

As for the other EU Member States, only 5 of them managed to transpose the 5th AML Directive within the set deadline[33], the remaining countries are gradually adopting the relevant legislation at a national level. As the Directive sets out the objectives to be achieved, but not the exact manner, the various solutions of the Member States may differ. For example, Poland has set up a register of beneficial owners (Centralny Rejestr Beneficjentów Rzeczywistych) as a separate information system of the state administration, whereby registered data are not linked to the commercial register, but access to the register is open to the public. Compared to the other Member States, Poland has opted for a very high fine for breach of registration obligations, up to EUR 218 000.[34] Austria set up the register in 2018 as a separate register of beneficial owners (Register der wirtschaftlichen

[30]MPR PARTNERS. Romania: Corporate statements regarding ultimate beneficial owner(s). *Lexology* [online]. 4 March 2020 [viewed 4 October 2021]. Available from: https://www.lexology.com/ library/detail.aspx?g=c2222ec4-27c3-4530-b248-7e3f906551f7.

[31] BEDROS, L., *supra note 22*.

[32] ANDREI, Elena. Romania simplifies registration formalities for ultimate beneficial owners. *CMS LAW* [online]. 9 July 2020 [viewed 4 October 2021]. Available from: https://www.cms-lawnow.com/ealerts/2020/07/romania-simplifies-registration-formalities-for-ultimate-beneficial-owners.

[33] Anti-money laundering directive V (AMLD V) - transposition status. *European Commission* [online]. [viewed 4 October 2021]. Available from: https://ec.europa.eu/info/publications/anti-money-laundering-directive-5-transposition-status_en.

[34] LEWANDOWSKI, Paweł. The Central Register of Beneficial Ownership: A new obligation for corporate and other legal entities. In*: Míľniky práva v stredoeurópskom priestore 2020*. Univerzita Komenského, Právnická fakulta, 2020, pp. 371–383. ISBN 978-80-7160-576-8.

Eigentümer) and currently meets the requirements of the 5th AML Directive.[35] The register and its operation are subordinated to the Federal Ministry of Finance and is using, similarly to Denmark, many automated verification (and even sanctioning) processes to ensure the quality of registered data. Sanctions are also relatively high – up to EUR 200,000 for intentional breaches of the provisions of the Register Act and up to EUR 100,000 for gross negligence.[36] In Austria, the risk system is also innovative, which is based on the principle that for foreign beneficial owners, the system assesses the degree of risk depending on the transparency of the jurisdiction where the beneficial owner has a residential address.[37] For legal entities that have a residence address of the beneficial owner in a high-risk or very high-risk jurisdiction, there is a greater chance that the registration office will examine the beneficial ownership dossier or even perform a real ownership analysis directly at the legal entity's registered office.[38]

## CONCLUSION

In this relatively limited space, we have tried to approach the direction in which the regulation of beneficial ownership is developing within the EU member states after the adoption of the 5th AML Directive. Many states have opted for various innovative methods of identifying beneficial owners or verifying data in the registry, others have opted for severe sanctions to force companies to take AML's obligations seriously, and some other states have only adopted a very light version of the obligations they had to accept under the directive. In this context, it is very important to realize that, although the obligations associated with AML regulation are perceived as socially desirable, they bring many administrative obligations for entrepreneurs. It is therefore in the interest of the State, in terms of competitiveness, to seek to impose these obligations on private entities as little as possible, while maintaining the highest possible quality of the collected data. Here, the positive examples are states that have not only adopted the directive minimum, but have developed this area and, above all, used the possibilities of

[35] PANICO, Paolo. Private Foundations and EU beneficial ownership registers: towards full disclosure to the general public? *Trusts & Trustees*. 2020, 26(6), 493–502. ISSN 1752-2110. Available from: doi:10.1093/tandt/ttaa055.

[36] The Register of Beneficial Owners. *Das Bundesministerium für Finanzen* [online]. [viewed 4 October 2021]. Available from: https://www.bmf.gv.at/en/topics/financial-sector/beneficial-owners-register-act/Register-of-Beneficial-Owner.html.

[37] PETRITZ, Michael, and Cordula HORKEL-WYTRZENS. The treatment of Austrian private foundations under the Ultimate Beneficial Ownership Act. *Trusts & Trustees*. 2019, 25(6), 650–655. ISSN 1752-2110. Available from: doi:10.1093/tandt/ttz048.

[38] KNOBEL, Andres. FATF beneficial ownership report reveals cutting-edge verification processes, hesitates to endorse public registries. *Tax Justice Network* [online]. 27 November 2019 [viewed 5 October 2021]. Available from: https://www.taxjustice.net/2019/11/27/fatf-beneficial-ownership-report-reveals-cutting-edge-verification-processes-hesitates-to-endorse-public-registries.

the 21st century and introduced as much automation as possible into the registration process. States should therefore seek to register available data automatically, require the cooperation of entrepreneurs in more complicated cases, introduce strict and creative sanctions to prevent and adopt thorough verification of registered data.

For example, Slovakia currently has two different regulations that collect the same data, but each in a different way and for a different purpose. In our opinion, the Slovak legislator should define this area more precisely, work more effectively with the possibilities it has within the AML regulations and unify the data on beneficial owners in one register. The benefits are not only on the part of the private sector – i.e. the elimination of duplication of legislation and transparency of obligations, but also the state would save the cost of operating the RPSP. In addition, in terms of the purpose of AML regulation and RPSP - public supervision of the ownership structures of companies, we have chosen as the most suitable Business Register, which has one of the largest website traffic from public administration portals. However, when registering within the single register, we are in favour of maintaining the separation of public sector partner status and AML registrations, as both aims at slightly different objectives and groups of entities. Therefore, we would not apply the RPSP tools to AML registration, but the opposite is possible. If the Slovak legislator were to be inspired by innovative methods of registration, sanctions or data verification, which are currently in practice in the other Member States, these could also increase the quality of data of registered public sector partners.

The trend in this area shows, especially in the context of law in business, that in the future the legislator should not burden the private sector with excessive regulation and bureaucratic obligations. On the contrary, it should make every effort to use innovative technological solutions, artificial intelligence and evaluate big data in an automated way that allows identifying risks with much greater accuracy.

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# Choice of law in insurance and liability for damage of the State

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***Abstract:*** *This paper deals with the possibilities of choice of law in the field of personal insurance in a comparison of Czech and Slovak law, the question of the legitimacy of geoblocking in the distribution of insurance and with liability of the state for damages in the event that its national law is in conflict with EU law. The Rome I Regulation allows national legislatures to adopt looser rules in certain cases. Slovak law allows for greater flexibility but did not take the restrictions of Rome I Regulation into account. If an insurance company chooses the law under Slovak Act No. 97/1963 Coll. on Private International Law and Procedure, is such a choice valid and would the state be liable for damages?*

***Keywords:*** *Choice of law, Insurance, International private law, Geoblocking.*

## INTRODUCTION

Choice of law applies when there is a sufficiently significant international element in the contractual relationship that constitutes a particular relationship with a foreign country.[1] The international element may be either objective, present regardless of the parties' intention (particularly based on their habitual residence or place of performance), or subjective, governed by the intention of the parties (choice of foreign law for the contractual relationship, even for a domestic one). All elements relevant to the situation can be located in a country other than the country whose law has been chosen.[2] However, in case of adhesion insurance contracts available to the general public, such flexibility is questionable. Requirements for the exercise of due professional care in the conduct of insurance business, being obviously interpreted in the light of the protection of the weaker party (especially consumer), must be taken into consideration. The supervisory authorities are increasing their pressure on the quality of insurance services, including by interfering with the autonomy of the will of the contracting parties. In this

[1] The article has been supported by the SVV grant "The development of financial and criminal law regulation under the influence of the European Union law"- *„Vývoj finančněprávní a trestněprávní regulace pod vlivem normotvorby Evropské unie“*, SVV 260 493/2020 and by the GAUK grant *„Creation and distribution of insurance in changing legal environment“ „Creation and distribution of insurance in changing legal environment“, GAUK 650520.*

[2] Regulation (EC) No. 593/2008 on the law applicable to contractual obligations (hereinafter “Rome I Regulation”), Art. 15.

paper, the author deals with the comparative analysis of Czech and Slovak legislation aimed at choice of law and liability of the state for damages caused by a conflict between national law and EU legislation. The author also discusses the legitimacy of geo-blocking as a preventive solution to the application of an undesirable legal regime.

## 1. BASELINE CONDITIONS FOR CHOICE OF LAW

Before making a choice of law, it is necessary to establish a set of initial conditions. It must be determined whether the offer is to be published on the internet in a neutral form and accessible to all potential customers regardless of their place of habitual residence, whether it is to be actively marketed in certain countries or adapted to such a target market,[3] or whether, on the contrary, it should be unavailable in certain states. Rome I regulation contains specific restrictions on the choice of law for insurance relationships in relation to risks located within the EU;[4] for risks outside member states, the general rules for consumer contractual relations apply.[5] The State where the risk is situated corresponds to the place where the risk is covered by the insurance, whereas the member state where the risk is situated within the meaning of the Solvency II Directive[6] may not correspond to this location. In the case of personal insurance, the risk is artificially located in the country of habitual residence, or the place where the insurance was taken out, in order to build up insurance reserves, ensure the solvency of the insurance company and manage its financial risks.[7] Tax considerations are also relevant here.[8] In a separate treatise,[9] aimed at isolated analysis of Rome I Regulation in relation to the Solvency II Directive, the author concludes that a certain flexibility in the choice of law cannot be excluded only in the case of travel insurance. In the case of life insurance, only the law of the nationality of the policyholder can be chosen and, if no choice is made, the law of the policyholder's habitual residence governs the contract. For non-life insurance of persons, except where the coverage of risks is limited to the territory of a single member state, the legal regime of the habitual residence of the policyholder cannot in principle be avoided, unless the national law of a member state offers a different recourse.

[3] As defined by Commission Delegated Regulation (EU) No. 2017/2358, Art. 5.
[4] Rome I, Art. 7.
[5] Rome I, Art. 6.
[6] Directive No. 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Art. 13 S. 13.
[7] Solvency II., eg. Art. 30 or Art. 206 S. 2 in relation to private health insurance.
[8] Solvency II., Art. 157.
[9] Kult, A. Choice of Law in Distance Insurance Contracts. In Škrabka, J., Vacuška, L. (eds.). Law in Business of Selected Member States of the European Union. Proceedings of the XII International Scientific Conference.Prague: TROAS, s.r.o., 2020, ISBN: 978-80-88055-10-5, p. 181 – 190.

If an insurer offers insurance that will be available (even over the internet) abroad, it is reasonable to choose the law that will govern the contract. It is assumed that by establishing relations with foreign customers, an international element will enter to the contracting process and a conflict of laws will arise, which is potentially already present at the time of the choice of law in the adhesion contract proposal. It cannot be ruled out that the courts will find in specific cases that, if the offer of insurance was available to customers in a particular country, then the activity was directed to that country.

Given that the choice of law should primarily depend on the will of the parties[10] and the Rome I Regulation is directly applicable, there are no legal restrictions even on the act of choice of law itself to be made directly based on Rome I Regulation because there is no link to *lex fori*. For example, a Czech subject can choose Slovak law although Czech legal regulation of international private law does not allow this possibility because the Rome I Regulation allows greater flexibility which was used by the Slovak legislator. However, it should also be noted that such a choice of law made by the insurance company would be made on shakier ground in case of consumer contracts, as it may be assessed as inconsistent with the requirements of due professional care[11] and violating the protection of the weaker party. The abstract legal term of professional care can be interpreted very broadly and, for example, the Czech National Bank often does so.[12] Its violation could be seen, given the specific position of weaker parties in adhesion contracts, as a unilateral choice of law. This is de facto only made by the stronger party (the insurance company), while the weaker party (the potential policyholder) has the option either to accept it or not to conclude the contract (so called „*take it or leave it*").

[10] Rome I, Art. 3(1).

[11] Requirement on acting with professional care is stipulated by S. 6 (1) of the Law No. 277/2009 Sb., on Insurance. The term professional care is not defined here. The general definition may be found in S. 5(1) of the act no. 89/2012 Coll., the Civil Code: "*A person who offers professional performance as a member of an occupation or profession, whether publicly or in dealings with another person, demonstrates his ability to act with the knowledge and care associated with his occupation or profession. If the person fails to act with such professional care, he bears the consequences".* For the consumer relations, it is defined in S. 2(1) p) of the Law No. 634/1992 Coll., on Consumer Protection, as a "*standard of special skill and care, which can be reasonably expected from an entrepreneur in relation to a consumer and which is in compliance with honest trade practices or general principles of good faith in that entrepreneur's field of activity*."

[12] See for example Regulatory Benchmark No. 1/2013 „*Professional Care in Offering Investment Life Insurance*", Regulatory Benchmark No. 3/2019 „*References in the Insurance Contract and Terms and Conditions to Other Documents*," and Regulatory Benchmark No.1/2019 „*on Certain Obligations of Insurance Undertakings Relating in Particular to the Termination of Reserving Life Insurance Contracts on Reaching a Certain Age or a Date Specified in the Contract as the End of the Insurance*."

## 2. COMPARISON OF CZECH AND SLOVAK LAW, COMPLIANCE WITH THE ROME I REGULATION

Choosing applicable law within the limits of the Rome I Regulation may be disadvantageous not only for the insurer but also for the policyholder, who is interested in freely negotiating the appropriate legal regime. However, the options of choice of law are limited in the context of group risks even in relationships without a consumer element. Even though it is no secret that the choice of law rules on insurance contracts in the Rome I Regulation were adopted as a provisional solution and with full awareness of their shortcomings, the revision planned in Art. 27 Rome I Regulation has still not been attempted[13] although the review was intended to be done until 17 June 2013 and should be aimed specifically at insurance contracts.[14] The rules of choice of law in insurance contracts are very complicated and also the leading experts on international private law heavily criticize it and call it a failure.[15]

Member states may grant a greater freedom in the choice of applicable law in the cases referred to in Article 7(3)(a), (b) or (e). This allows, inter alia, a derogation from the option linked to the place where the risk is situated at the time of concluding the contract and from the option associated with the place of habitual residence of the policyholder. This flexibility is not possible for life insurance (point (c)). Thus, national law can always derogate from the choice-of-law rules in non-life insurance and enact a greater degree of freedom. This is notwithstanding Article 6, since Article 7 is a special provision and financial instruments are excluded from the application of Article 6.[16] The life insurance contract must therefore be governed by the law of the nationality or habitual residence of the policyholder.

A specific situation in this respect is when, for example, a Slovak citizen wants to take out life insurance in the Czech Republic. In accordance with Czech law and the Rome I Regulation, only Slovak law can be chosen and if no choice is made, the law of the place of habitual residence applies. For such purpose, it would be necessary to prove that the person concerned has the "*center of gravity*

[13] MIQUEL SALA, Rosa. Los contratos de seguro en el proyecto de Ley Modelo OHADAC de Derecho internacional privado. ¿Un modelo a seguir para el Reglamento Roma I? in *Anuario Español de derecho internacional privado, 2016. AEDIPr, t. XVI, 2016*, pp. 793–820 ISSN 1578–3138 DOI: 10.19194/aedipr.16.29.

[14] Rome I, Art. 27 (Review clause).

[15] HEISS, Helmut. Insurance Contracts in Rome I: Another Recent Failure of the European Legislature. In FERRARI, Franco and Stefan LEIBLE. *Yearbook for Private International Law* (10) 2008. Lausanne: Sellier European Law Publishers, 2009. pp.261-283. 9783866538566.

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*of life*"[17] in the Czech Republic, i.e. in particular a permanent residence permit, but also, for example, an employment relationship or any other demonstrable long-term relationship with the territory of the Czech Republic. In order to conclude a contract under Czech law, a legal entity, as a policy holder, would have to have an establishment in the Czech Republic. For example, if the potential policy holder is a company with its registered seat in Slovakia not having a branch in the Czech Republic, it will be unable to conclude an insurance contract under Czech law unless it covers its business activities in both countries. Therefore, if such a company would want to insure e.g. the life of its executive director, the contract must be governed by the Slovak law, even if the managing director is a Czech citizen.

However, it could happen that the choice of law will be made pursuant to Slovak law, which, irrespective of the insurance sector, allows the choice according to the insurer's registered seat. The Slovak Act No. 97/1963 Coll., on International Private Law and Procedure (hereinafter referred to as "97/1963 SK"), replicating the original Czechoslovak legislation, states that insurance contracts, including real estate insurance contracts, are governed by the law of the insurer's registered office at the time the contract is concluded, with the restriction that if a special legal regulation provides otherwise, it is necessary to follow it.[18] If no applicable law is chosen, the relevant contractual relationship shall be governed by the law whose application corresponds to a reasonable arrangement of the relationship.[19] Although it is further applicable to the choice of law concerning legal relations with subjects from non-EU countries, it is not compliant to the Rome I Regulation and, therefore, not applicable. If the parties to a consumer contract have chosen a law that provides less protection for the consumer's rights than Slovak law, their relations are governed by Slovak law.[20] So it also does not provide for the protection of the foreign consumer.

The Rome I Regulation, despite its direct applicability, is not in the relationship of a special rule to the Slovak national law, in which it was not reflected due to the inactivity of the legislator. The Solvency II Directive does not provide for choice of law rules, but only for risk placement rules. Although the definition of placement of risk has been transposed into the Slovak Insurance Act quite exactly[21] it cannot, in the author's opinion, be considered a special choice of law regulation, as the definition of risk placement has no special relationship to the choice of law rules under the 97/1963 SK.

The Act No. 91/2012 Coll., on International Private Law (hereinafter referred to as "91/2012 CZ") provides that insurance contracts are governed by the

[17] Decision of the Highest Court of the Czech Republic of 27th September 2011, File No. 30 Cdo 2244/2011.
[18] 97/1963 SK, S. 10 (2) d).
[19] 97/1963 SK, S. 10 (1).
[20] 97/1963 SK S. 9 (3).
[21] Act no. 39/2015 Coll., on Insurance S. 5 m).

law of the state in which the policyholder has their habitual residence. The parties may choose the law applicable to the insurance contract; if the directly applicable regulation of the European Union applies to the insurance contract, the contracting parties may, to the extent permitted by that regulation, choose any applicable law.[22] This directly applicable regulation is the Rome I Regulation, to which the Czech law is compliant.

Provisions of national laws that conflict with Community law, which is superior to them, should be considered inapplicable.[23] Nevertheless, the principle of trust in the law and legal certainty must be respected. The author does not consider it sufficient to say that the rules of choice of law are obsolete in the extent non-compliant to Rome I Regulation.

According to the Constitutional Court, every public authority is obliged to apply EU law in preference to Czech law if the latter conflicts with it.[24] The Constitutional Court of the Slovak Republic has so far not dealt with the issue of conflict of provisions of EU law with the legal order of Slovakia in its decision-making practice. The European courts have so far addressed this issue only in cases where a private law entity has sought direct effect of more favourable provisions of EU law against less favourable national law.

## 3. LIABILITY FOR DAMAGE CAUSED BY AN INFRINGEMENT OF EU LAW

Can the individual addressees of the national rules be held responsible for having complied with them? And if they suffer damage in that connection, can they claim that damage against the State whose law they have chosen and followed? Crucial to the assessment of these questions may be the nature of the parties and their contractual relationship or whether they acted in simple reliance on the law or have deliberately chosen that law in order to avoid 'inconvenient' restrictions on the choice of law.

If the Slovak insurance company suffered damage as a result of the fact that it chose the legal regime of the insurance contract in accordance with the 97/1963 SK (but in contravention of the Rome I Regulation, because the greater freedom is not granted for life insurance), the question is whether the Slovak State can be held liable in such a situation for damage caused in the exercise of public authority. Would this situation be different, if the parties to the contract were only parties with balanced bargaining position, especially "ordinary people" whose knowledge of inapplicability of local law due to precedence of EU Law can be hardly expected? Does the knowledge of non-compliance of Slovak law with EU Law play a role? Does the principle "*ignorantia legis non excusat"* apply to it?

[22] 91/2012 CZ, S. 87 (3).
[23] Judgement of the Court of 4 April 1974. Commission of the European Communities v French Republic. Case 167-73.
[24] Decision of the Constitutional Court no. Pl. ÚS 19/04 from 21st February 2006.

Slovak legal regulation[25] includes the National Council, i.e. the Slovak parliament, among the bodies acting on behalf of the state in the matter of compensation for damages. Maladministration[26] means also inactivity of the particular body,[27] ie the obligation of a public authority to take an act or issue a decision within the time limit prescribed by law. Although adopting laws is explicitly excluded from the scope of 514/2003 SK,[28] it should not be applicable to inactivity related to adapting domestic law to EU law, because the breaches of EU law are attributable to the national legislature.[29] In view of the fact that the current wording of section 10(2)(d) of the 97/1963 SK has never been amended and is therefore in its original wording as on 1 April 1964, there is no doubt that the Slovak National Council's failure to amend or repeal the mentioned provision can be seen as its inaction.

In the Czech Republic it is not entirely clear if it is possible to claim damages on the basis on Act No. 82/1998 Coll., on Liability for Damage Caused in the Exercise of Public Authority by Decision or Improper Official Action (hereinafter referred to as the "82/1998 CZ"). It establishes the liability of the State for an unlawful decision in the form of an individual legal act or missing the statutory deadline for decision.[30] It seems not to be applicable to inaction in the legislative process. Firstly, the Highest Court held[31] that process of passing laws by voting in the Chamber of Deputies or the Senate of the Parliament of the Czech Republic is not an official procedure within the meaning of Section 13, and the result of the vote on a bill cannot imply liability of the state for damages in relation to individual voters. Later on, this legal opinion was declined by the Constitutional Court with a conclusion (pertinent to the discussed case) that „the inaction of the legislator (as a representative of one branch of public power in the state), who did not adopt the regulation of a unilateral increase in rent, is in conflict with the constitutional order".[32] Therefore, it implies that 82/1998 should apply also for inaction in the legislative process.

Relevant to this situation is also another decision adopted by the Court of Justice of the EU (CJEU),[33] which held that the obligation to compensate for

[25] 514/2003 SK, S. 4 (1) j).
[26] In the meaning of 514/2003 SK, S. 3 (1) d).
[27] 514/2003 SK, S. 9 (1).
[28] 514/2002 SK, S. 6 (4).
[29] Judgement of the Court of 5 March 1996. Brasserie du Pêcheur SA v Bundesrepublik Deutschland and The Queen v Secretary of State for Transport, ex parte: Factortame Ltd and others. Joined cases C-46/93 and C-48/93.
[30] The definition in S. 13 (1) is similar to that in the Slovak law, i.e., a breach of the obligation to adopt an act or issue a decision within the time limit set by law.
[31] Decision of the Highest Court of the Czech Republic File No. 25 Cdo 1124/2005.
[32] Decision of the Constitutional Court of the Czech Republic File No. II. ÚS 122/08.
[33] Judgment of the Court of 19 November 1991. - Andrea Francovich and Danila Bonifaci and others v Italian Republic. - References for a preliminary ruling: Pretura di Vicenza and Pretura di Bassano del Grappa - Italy. - Failure to implement a directive - Liability of the Member State. - Joined cases C-6/90 and C-9/90.

incorrect or delayed implementation of a directive derives directly from EU law where the result of the directive gives rise to sufficiently certain rights for individuals, the content of those rights is identifiable on the basis of the provisions of the directive and there is a causal link between the breach of the obligation by the State and the damage suffered by the aggrieved parties.

However, the situation is different compared to a case where the domestic law is not in compliance with the Rome I Regulation. It is not a case where the national legislature has failed to grant the addressees of national law certain rights under the directive, as in the Francovich case, where the requirement to protect employees against the insolvency of their employer was not implemented in Italian law. The state omitted to grant the rights envisaged by the EU law to the persons concerned. However, now the author discusses a situation where Slovak law allows insurance companies a wider choice of law. The injured party here may therefore be the policyholder who is habitually resident in another member state. The injured party could then argue that the choice of law in the insurance contract is invalid. If the insurer were to lose the litigation against the policyholder, it could, for example, incur damages in the form of legal costs, which it could theoretically claim against the Slovak State. However, in the author's opinion, the causal link between the breach of the State's obligation and the damage suffered would be very difficult to prove. Claims from member state liability are rarely successful. It is suggested that a number of factors come into play, on the basis of which the limits of member state liability as a private enforcement mechanism can be shown. The conditions for state liability set by the CJEU are very hard to satisfy and have not been clearly defined by the Court.[34]

## 4. GEO-BLOCKING AS A SOLUTION

The choice of law in insurance relationships is closely related to the concepts of "*directed activity*" and "*place where the policyholder took out the policy*." If a distributor, whether an insurance company or an intermediary, puts an insurance offer on the internet, it may have the intention to sell this insurance to clients all over the world without directing its offer to a particular state. Based on the very restrictive limitation of choice of law by the EU law, geo-blocking should be seen as justified in the insurance sector. This is probably the reason why financial services (including insurance) are exempted from the scope of the Regulation on unjustified geo-blocking.[35] In the author's opinion, geo-blocking

[34] LOCK, Tobias. Is private enforcement of EU law through state liability a myth? – An assessment 20 years after Francovich in *Common Market Law Review, vol. 49, no. 5*, pp. 1675-1702. ISSN 0165-0750. Available from: LOCK_Is_Private_Enforcement_of_EU_Law_Through_State_Liability_a_Myth.pdf (ed.ac.uk).

[35] Under Article 1(3) of Regulation (EU) No 2018/302 of the European Parliament and of the Council of 28 February 2018 on addressing unjustified geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market, this Regulation does not apply to the activities referred to in Article 2(2) of Directive

in the insurance sector cannot violate the principle of non-discrimination within the internal market, as the transaction costs associated with adapting to all potentially applicable laws would be extremely high. Thus, if geo-blocking is used in the online distribution of insurance, it is a legitimate protection for insurers against the consequences of the invalidity of choice of law and the unpredictability of the legal regime of insurance contracts. The official justification in the recital of Directive 2006/123/EC[36] is, that financial services are excluded from the scope of this Directive because they are the subject of specific legislation under EU law which, like this Directive, is aimed at achieving a genuine internal market in services.

## CONCLUSION

The simplest way to increase cross-border provision of insurance services without disrupting the functioning of individual national markets is to abandon the difficult path of harmonisation and to allow insurers to distribute insurance in other Member States based on their choice of contract law. However, this route has already been rejected due to the lack of consumer protection in the legislation preceding the Rome I Regulation.[37] Therefore, even insurance products sold across borders have to be adapted to the mandatory rules of the country where they are sold, making it practically impossible to achieve a single market for insurance services.[38] A certain alternative is represented by the Principles of European Insurance Contract Law, which, if chosen, apply instead of the rules of private international law, but in the author's opinion may be difficult to apply in consumer contracts, where the choice of law is in fact made only by the stronger party to the contract and the weaker party (especially consumer) may argue that the choice of law is invalid. Although the Rome I Regulation can be seen as an important tool in structuring multi-jurisdictional insurance,[39] it is, in the author's opinion, the main obstacle to achieving a single market for insurance services. Although the Rome I Regulation allows a freer choice of law regime only for non-life insurance contracts, Slovak law extends it to life insurance as well. How-

2006/123/EC on services in the internal market, i.e. financial services, among which insurance is expressly mentioned.

[36] Directive 2006/123/EC, Recital, Art. 18.

[37] COUSY, Herman. Insurance Contract Law: An Age-Old, Slow and Unfinished Story. In: Pierpaolo MARANO and Michele SIRI, eds. Insurance Regulation in the European Union: Solvency II and Beyond. Cham: Palgrave Macmillan, 2017, pp. 31-58. 9783319612157, p. 50 – 51.

[38] OSTROWSKA, Marta. Transparency in the Insurance Contract Law: A Comparative Analysis Between the Principles of European Insurance Contract Law (PEICL) and selected European Legal Regimes. In: Pierpaolo MARANO and Kyriaki NOUSSIA, eds. Transparency in Insurance Contract Law. Cham: Springer Nature Switzerland AG, 2019, pp. 279–294. 9783030311988, p. 280.

[39] SAMOTHRAKIS, Yannis. France. In: Pierpaolo MARANO and Ioannis Rokas, eds. Distribution of Insurance-Based Investment Products. Cham: Springer Nature Switzerland AG, 2019, pp. 129–152. 9783030116675, p. 131.

ever, if an insurance company follows Slovak law and subordinates the life insurance contract available to foreign citizens to its domestic law, such choice will be invalid. On the other hand, in case of Slovak insurance company, it can be hardly considered a breach of professional care,[40] because the company acted in trust in law. However, if such a choice of Slovak law would be made by the Czech insurance company, it may be perceived as an arbitrary step breaching the professional care.

In the author´s opinion, the direct applicability of EU regulations presents a distortion of the hierarchy of law, especially in continental legal systems. The member state concerned is responsible for the lack of or incorrect implementation of directives that are not directly applicable, including directly towards the addressees of national legislation. A similar responsibility (and liability) can be attributed to such a State when it fails to adapt its legal system to directly applicable legislation, i.e. a regulation. If a member state considers the non-compliant provision of national law obsolete and does not make it compliant with EU law, it hereby violates the principles of trust in law and legal certainty. If any addressee of certain law were to suffer damage in connection with a choice of law made based on the applicable provisions of Slovak law, it would be, based on the author´s opinion, possible to claim it against the Slovak State. If an ordinary citizen were in this position instead of a financial institution, the likelihood of success in such a dispute is even stronger. The expected knowledge of EU Law may play a significant role in assessing specific cases because the insurance company should be probably better aware of the precedence of EU Law than an ordinary citizen. However, in the author´s opinion, the level of expected knowledge should not absolve the member states of responsibility and liability for non-compliance of their national law with EU law. The principles of trust in law and legal certainty should prevail over applicability of the *ignorantia legis non excusat* principle applied to knowledge of non-compliance of national law with EU law.

Geo-blocking is not regulated in the insurance sector and, in view of the limits on choice of law arising directly from EU law, it can be seen as justified and non-discriminatory in this area, as the transaction costs associated with the need to align the contractual and pre-contractual documentation to the laws of member states where the particular insurance can be purchased (especially online), would be disproportionately high, as would the need to translate the documents and provide administrative support for foreign customers. An insurance company has the right to freely choose its contractual counterparty and is therefore not obliged to conclude contracts with customers with whom it does not wish to conclude them.

[40] Act No. 39/2015 Coll., on Insurance (SK), S. 70.

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# The role and function of a bond security agent – problems and challenges

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***Abstract:*** *The legal regulation of the agent for securing receivables arising from issued bonds (bond security agent) in the Czech and Slovak legal system was inspired by common law, where the "bond trustee" is well established and brings long-term positive effects. However, since this is an institute derived from the legal regime of a trust, which has its roots in the common law legal system and the continental law did not initially know it at all, its application and legal regulation raises several legal problems (e.g. credit risk of the bond security agent, its conflict of interest, liability, termination of its position etc.). In this paper we analyze these problems and challenges, mostly derived from insufficient or unclear regulation and impact thereof on functioning of bond security agent in practice. We also propose several legislative changes of this legal institution.*

***Keywords:*** *bond security agent, bond trustee, pledge, conflict of interest, legal liability, security interest.*

## INTRODUCTION

The security agent is a legal institution that originated in the Anglo-American legal system and has its origins in the institution of the trust. The legal regulation of trust is based on case law, namely the law of equity, which complements the original common law institute.[1]

A trust fund is a set of assets without legal personality set aside for a specific purpose by the settlor, managed by a designated person - the trustee - for the benefit of a third party - the beneficiary. The creation of a **trust** separates the assets in question from the settlor's assets but does not make them the property of the trustee. It remains separate and distinct, but has no legal personality.[2] The most important types of trust are the express trust, the implied trust, the constructive trust, the resulting trust and the charitable trust.[3]

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[1] HRUŠKOVIČ, I., KALESNÁ, K., ŠTEFANOVIČ, M. *Svetové právne systémy*. Bratislava: Univerzita Komenského Bratislava, 1996, p. 69.
[2] PENNER, J.: *The Law of Trusts. 8th edition.* Oxford: Oxford University Press, 2012, p. 22.
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The principle of a trust is that the settlor provides certain assets to a trustee, while at the same time entrusting the trustee to manage those assets for the benefit of the beneficiary. The trust is set up by the settlor in the trust deed. The settlor of the trust may also be the beneficiary himself, who, for example, entrusts a bank to manage his own assets so as to pay a regular return on them for his benefit. Finally, a model where the settlor establishes the trust by entrusting himself as trustee to manage the assets for the benefit of another person, the beneficiary, is not excluded.[4]

The legal regime of a trust has two essential practical impacts:

- all income derived from property held in trust fund or property acquired for property held in trust fund also becomes part of the trust fund; and

- in the event of the bankruptcy of the trustee, the assets held in the trust fund shall be excluded from the trustee's estate and shall not be affected by the creditors of the trustee.[5]

From a practical point of view, the **law of trust in England** is of particular importance, where it is contained in two basic statutes - the Trustee Act 1925 and the Trustee Act 2000 - in addition to court precedents. Also of considerable importance is **New York law**, which is supplemented by the federal Trust Indenture Act of 1939. As the concept of trust is not universally accepted and some countries (especially of the continental legal system[6]) do not recognize it at all, one of these two jurisdictions tends to be chosen as the governing law for both the legal relations arising from the trust and the bond issue itself in the case of cross-border bond issues.[7]

Diverse national legislation was also the reason for the adoption of the **Convention on the Law Applicable to Trusts and on their Recognition**

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*Komenského v Bratislave dňa 28. septembra 2018*. Bratislava: Právnická fakulta Univerzity Komenského v Bratislave, 2018, p. 28. For a more detailed description of the different types of trust, see ibid.

[4] KNAPP, V.: *Velké právní systémy*. Praha: C. H. Beck, 1996, pp. 182-183.

[5] WOOD, P. R.: *Comparative Law of Security Interests and Title Finance. Part 2: Legal Topics. 2nd edition.* London: Sweet & Maxwell, 2007, p. 79.

[6] Of course, with several exceptions, e. g. Czech Republic (see e.g. RONOVSKÁ, K.: *'Svěřenský fond' (Trust fund): A Daring New Legal Transplant in Czech Law*. In.: FARRAN, S., GALLEN, J., HENDRY, J., RAUTENBACH, CH. (eds.): The Diffusion of Law: The Movement of Laws and Norms Around the World. 1. ed. London: Ashgate, 2015, pp. 203 - 211), Switzerland (see e. g. PETER, N.: *Introduction of a trust law in Switzerland*. In.: Trusts & Trustees, 2019, 25 (6), pp. 578–586), Liechtenstein (see e. g. NIEGEL, J.: Liechtenstein Trusts: An Overview of the Law and Practice. In.: Trusts & Trustees, 2004, 10 (6), pp. 19-25) etc.

[7] ICMA-NAFMII Working Group: International Practices of Bond Trustee Arrangements. (https://www.icmagroup.org/assets/documents/Media/Press-releases-2018/ICMA-NAFMII-PR---Adopting-International-Practices-of-Bond-Trustee-Arrangements-in-China-051218.pdf [30.9. 2021]), p. 12. An example of such a bond issue in the Czech Republic, which was governed by the law of the State of New York, is given in his doctoral thesis by D. Bujgl (BUJGL, D.: *Agent pro zajištění v českém právním řádu. Rigorózní práce.* Praha: Právnická fakulta UK, 2021, p. 60 et seq., https://dspace.cuni.cz/handle/20.500.11956/125184 [30.9.2021]).

(Hague Trust Convention)[8] in 1985, to which 14 countries of the world have acceded[9]. Neither the Czech Republic nor the Slovak Republic are contracting parties.[10]

Additionally, a **Model Law on Secured Transactions** was drafted in 1994 at the European Bank for Reconstruction and Development (hereinafter referred to as "EBRD"). This Model Law is not intended as detailed legislation for direct incorporation into local legal systems. It is, however, intended to form the basis for national legislation. It seeks to combine carefully worded and detailed legal text with a high degree of flexibility to enable adaptation to local circumstances. The principal perspectives are both to harmonize the approach to security rights legislation and to provide guidance as to expectations of international investors and lenders.[11] The scope of the Model Law is broader and applies to all secured transactions, not just secured bonds.[12] The EBRD Model Law on Secured Transactions is not to be confused with the **UNCITRAL Model Law on Secured Transactions**[13], the content of which is much more general.[14]

In 2006, two Common Frame of Reference working groups were established in the European Union. One of the groups, the Acquis Group, deals, among other things, with the unification of the law applicable to trusts, and its work resulted in the creation of the **Draft Common Frame of Reference**, which also dealt with trusts.[15]

The above-mentioned attributes of a trust find significant practical application in the use of a so-called security agent. A security agent is typically used in cases where there is a plurality on the creditor side of the secured claim, i.e.

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[8] On the content of the Convention, see HAYTON, D.: *The Hague Convention on the Law Applicable to Trusts and on their Recognition.* In: International and Comparative Law Quarterly, 1987, vol. 36, pp. 260-282.

[9] https://www.hcch.net/en/instruments/conventions/status-table/?cid=59 [30.9.2021].

[10] An interesting analysis of the reasons why more countries have not acceded to the Hague Trust Convention is offered by D. Hayton in this paper: HAYTON, D.: *Reflections on The Hague Trusts Convention after 30 years.* In.: Journal of Private International Law. 2016, 12 (1), pp. 1-25.

[11] European Bank for Reconstruction and Development: Model Law on Secured Transactions (https://www.ebrd.com/news/publications/guides/model-law-on-secured-transactions.html [30.9. 2021]), p. 4.

[12] For more details see e.g. SIMPSON, J. L. – ROVER, J. H. M.: *An introduction to the European Bank's model law on secured transactions.* In.: NORTON, J. J. – ANDENAS, M. (eds.): Emerging Financial Markets and the Role of International Financial Institutions (Proceedings of a conference entitled "Emerging Financial Markets and International Financial Institutions" held in London on 25-26 May, 1995 at the European Bank for Reconstruction and Development). London – Boston: Kluwer Law International, 1996, pp. 165-170.

[13] https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/19-08779_e_e-book.pdf [30.9.2021].

[14] For further details see ROVER, J. H.: *The EBRD's Model Law on Secured Transactions and its Implications for an UNCITRAL Model Law on Secured Transactions.* In.: *Uniform Law Review*, 2010, 15 (2), pp. 479–506; KEIJSER, T.: *Non intermediated Securities: A European View on the Draft UNCITRAL Model Law on Secured Transactions.* In.: European Company Law, 2015, 12 (1), pp. 7-12.

[15] DAUDRIKH, Y.: op. cit., p. 31.

most commonly in the case of syndicated loans and in the case of secured bond issues. In this paper, we focus only on the latter case. In a broad sense, we refer to a **bond trustee**[16], who represents the holders of all bonds issued by a particular issuer, and in a narrower sense to a **security agent**[17] or, in the narrowest sense in relation to the creation of a pledge, to a **collateral agent**[18]. In a broader sense, a **charge manager** is a person who establishes security (charge) for the benefit of the pledgees[19], but in addition to securing the claims of the bondholders, it also applies, for example, to secured syndicated loans. In the following, we will use the term **security agent** which we consider to be the most appropriate.

Security agent in case of bond issuance is an independent third party that holds the collateral on behalf of the investors under a bond issue documentation as security for performance of the issuer's obligations towards bondholders and performs other assignments stipulated in the bond prospectus and the security agent agreement.[20] We will hereafter refer to such a security agent as a **bond security agent**.

The main scientific methods we use in this paper are the method of analysis, synthesis, induction and deduction, and especially the comparative method.

## 1. LEGAL POSITION OF THE BOND SECURITY AGENT IN THE CZECH REPUBLIC

Czech law until the entry into force of the Czech Civil Code No. 89/2012 Coll. did not regulate a pledge in favour of third parties nor did it – until the entry into force of Act No. 307/2018 Coll., which amended **Act No. 190/2004 Coll. on Bonds** (hereinafter referred to as the "Czech Act on Bonds" or "CAB") – regulate the institute of a bond security agent. Thus, its existence as well as its rights and obligations could only be based on contractual relationship.

The Czech Act on Bonds does not directly define a bond security agent, but only indirectly characterizes it through its rights and obligations. It is clear that its involvement is only possible in the case of secured bonds, i.e. when the nominal value of the bonds and other obligations thereunder are secured by the creation of a pledge or other security in favour of the bondholders or other beneficiaries specified in the bond prospectus. Such security shall be created by a

[16] For example, RAWLINGS, P.: *The changing role of the trustee in international bond issues.* In.: Journal of Business Law, 2007, 51 (1), pp. 43-66.
[17] For example KIENINGER, E.-M. (ed.): *Security Rights in Intellectual Property.* Cham: Springer, 2020, pp. 130, 570.
[18] For example ZARFES, D. – BLOOM, M. L.: *Contracts and Commercial Transactions.* New York: Wolters Kluwer, 2011, p. 342.
[19] European Bank for Reconstruction and Development: Model Law on Secured Transactions, Art. 16, pp. 17-18.
[20] GERSTER, C. – KLEIN, G. – SCHOPPMANN, H. – SCHWANDER, D. – WENGLER, C.: *European Banking and Financial Services Law*. Den Haag: Kluwer Law International, 2004, p. 136.

written agreement between the bond security agent as pledgee or other security beneficiary and the issuer of bonds or other security provider. To avoid potential conflict of interests only one bond security agent may be appointed in relation to a single bond issue (Art. 20 (1) CAB) and it must be identified in the respective bond prospectus (Art. 20 (3) CAB). This means that a security agent is appointed before the bondholders are even known. Therefore, the CAB creates a mechanism whereby the bondholders, through their meeting, have the right to instruct the bond security agent (Art. 20a(1) CAB), to control it and, if necessary, to dismiss it (Art. 20a(2) CAB). By a change of the bond security agent, its rights and obligations (including its rights and obligations arising from the contract concluded with the issuer and bond prospectus) will fully pass on the new security agent (Art. 20 (6), Art. 20a (2) CAB).

The bond security agent exercises the rights of a creditor, pledgee or other security beneficiary in their own name for the benefit of the entitled persons (mostly bondholders), including in the event of insolvency proceedings or enforcement of a decision towards the pledgor or other security provider or their assets. The performance obtained from the security belongs to the entitled persons (mostly bondholders) in the proportion determined in the bond prospectus; if the bond security agent is a bank or securities broker, the performance obtained is considered in this extent to be the customer's property pursuant to the Act governing capital market business (Art. 20 (2) CAB). This means that these assets are separate from the assets of the bond security agent and will not become part of the bankruptcy estate in the event of the bond security agent's bankruptcy. However, this is not the case if the bond security agent is neither a bank nor a securities broker.

The Explanatory Report to Act No. 307/2017 Coll., which introduced the institution of a bond security agent, admits that the exercise of their rights and duties is a commission-like relationship, however, it provides that the bond security agent shall not be deemed a commission agent and a legal fiction is created when it is viewed as if it were the holder of each bond within the entire bond issue and the creditor of each secured claim and therefore a pledgee or beneficiary of other security. Unlike the commission relationship, the contract is not entered into by the bondholders with the security agent, but by the bond issuer or if applicable, by the security provider if it is a person other than the issuer with the security agent. The investors (bondholders) implicitly consent to this contract (and their representation by agent) by agreeing to bond prospectus through purchasing the respective bond.[21] Thus, the bond security agent is not a commission agent, which on the one hand corresponds more to reality, but on the other hand makes it impossible to apply this institute analogically and to fill the gaps in the legal regulation. The Czech Act on Bonds also expressly provides that the provisions of the

[21]Point 39 of the Explanatory Report to Act No. 307/2017 Coll. (https://www.mfcr.cz/cs/soukromy-sektor/kapitalovy-trh/cenne-papiry/2017/novela-zakona-o-dluhopisech-predlozena-v-27569 [30.9. 2021]).

Czech Civil Code on administration of the property of another shall not apply to the bond security agent (Art. 20a (8) CAB). Its legal regulation is therefore based only on the provisions of the CAB.

The **rights of the bond security agent** include (i.a. Art. 20a (5) CAB):

a) exercise for the benefit of the entitled persons (mostly bondholders) all rights associated with a pledge or other security,

b) inspect the observance of the bond prospectus by the issuer in connection with a pledge or other security,

c) make other acts for the benefit of the entitled persons (bondholders) or otherwise protect their interests in connection with a pledge or other security[22],

d) right against the issuer for remuneration and reimbursement of expenses,

e) right to use the services of legal, accounting, tax or other advisers at the expense of the issuer[23],

f) right to require the pledgor to apply for registration of the pledge and, in the event that the pledgor fails to comply with this obligation in time, the right to apply for registration of the pledgor on its behalf,

g) right to request from the issuer (or the pledgor, if different from the issuer) certain information that the issuer (pledgor) is obliged under the relevant documentation to provide to the security agent[24] (e.g. on property situation, performance of specified covenants, etc.),

h) right to acquire, for their own account, bonds of the issue,

i) right to request instructions from authorized persons as to the conduct of its duties,

j) the right to resign from their position etc.

The **duties of a bond security agent** include:

a) duty of professional care - the bond security agent shall carry out their activities with a professional care, in particular they shall act in a qualified, honest and fair way and in the best interests of the bondholders (Art. 20a (4) CAB),

b) information duty – the bond security agent has obligation to disclose to the entitled persons (bondholders) without undue delay any material information relating to the pledge or other security, in particular information about any enforcement of the pledge or other security (Art. 20a (3) CAB),

c) they have to comply with the decision of the bondholders adopted on a bondholders' meeting at least by a simple majority of votes, regarding how the bond security agent is to exercise the rights from the relevant bond issue in respect of a pledge or other security (Art. 20a (1) CAB),

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[22] In the exercise of these rights, the bond security agent is deemed to be the creditor of each secured claim.

[23] For example Art. 4.8. of the Contact with the Security Agent concluded on 28. 1. 2021 (https://cdn.rohlik.cz/files/finance/EUO1-%232002369584-v1+Smlouva+s+agentem+pro+zajis%CC%8Cte% CC%8Cni%CC%81.pdf [30.9.2021]).

[24] BUJGL, D.: op. cit., pp. 78-82.

d) if in the event of

- termination of the activities of the bond security agent or
- a request to change the bond security agent by the bondholders whose total nominal value represents at least 5% of the total nominal value of the relevant bond issue

the issuer doesn´t convene the bondholders´ meeting without undue delay, this meeting has to be convened without undue delay by the bond security agent (Art. 21 (2) CAB),

e) the bond security agent is obliged to attend a meeting of bondholders convened for the purpose of discussing the issues referred to in point d) above or in the cases specified in the bond prospectus (whether convened by itself or by the issuer) (Art. 21 (4) CAB),

f) the performance obtained from the pledge or other security shall be distributed by the bond security agent among the bondholders in accordance with the ratio specified in the bond prospectus (Art. 20 (2) CAB),

g) provide the necessary assistance to the new bond security agent if there is a change in this position.

## 2. LEGAL POSITION OF THE BOND SECURITY AGENT IN SLOVAKIA

In contrast to the Czech law, the Slovak legislation on security agents is incomparably more concise. It does not even name this legal institute. The legal basis for the appointment of a security agent is provided by the secured bonds regulation in Art. 20b of the **Act No. 530/1990 Coll. on Bonds** (hereinafter referred to as the "Slovak Act on Bonds" or "SAB"). This issue is dealt with only in Section 20b (4), according to which a pledge in favour of bondholders may also be established by a contract concluded between the issuer or another pledgor and a common representative or another third party as pledgee. The pledgee shall exercise the pledge in their own name and for the account of the bondholders. Thus, the bond security agent may be deemed to be an 'other third party' unless it is the common representative of the bondholders.

It follows from the above very brief regulation that a security agent may be appointed also in Slovakia, where such person will act in their own name but on behalf of the bondholders when exercising the pledge. Since the execution of the pledge is a special case, which is not supported by any other legal regulation, we believe that the regulation of a commission agent acting under a commission contract (§ 577 et seq. of the **Commercial Code**) applies to the bond security agent *per analogiam*, i.e.:

- they have a duty to exercise due professional care in arranging the matter,
- they have a duty to act in accordance with the instructions of the bond-

holders, from which they may only deviate when it is in the interest of the bondholders and when it cannot obtain their consent on time,

- they have a duty to protect the interests of the bondholders known to them in connection with the arrangement of the matter and to notify them of any circumstances which may affect a change in their instructions,

- they have a duty to report to the bondholders on the arrangement in the manner specified in the contract or the bond prospectus, otherwise at their request,

- ownership of movable property acquired for the benefit of the bondholders shall be transferred to the bondholders by delivery thereof to the bond security agent,

- the bond security agent shall without undue delay transfer to the bondholders the rights acquired in the exercise of the pledge and shall deliver to them whatever it has acquired thereby, and the bondholders shall be obliged to take it over,

- upon completion of the exercise of the pledge, the bond security agent shall report to the bondholders on the result and submit a final statement thereof.

The law provides that the parties to a pledge agreement establishing a pledge securing the claims of the secured bondholders are the issuer or other pledge owner on the pledgor's side and the common representative of the bondholders or the bond security agent (the so-called "other third party") on the pledgee's side (Section 20b (4), first sentence SAB). This is logical, as the actual pledgees may not yet be known at the time of the conclusion of the pledge agreement or may change subsequently. It follows indirectly from this legal regulation that the bond security agent will also be registered as a pledgee in the relevant pledge register. However, unlike in the Czech Republic, there is no explicit legal regulation on this issue. Neither is there a regulation of many other practical issues, e.g.:

- the question of how to resolve a possible collision between the acts of the security agent and the acts of the bondholders,

- the mechanism for a change in the person of the bond security agent and its consequences,

- the effects of a transfer of the bond to a new creditor (bondholder) vis-à-vis the bond security agent.

The **rights and obligations** of a bond security agent are in practice very similar to those of this security agent in the Czech Republic, except that they are hardly regulated at all.

## 3. EVALUATION OF THE CZECH AND SLOVAK LEGAL REGULATION OF A BOND SECURITY AGENT

It can be concluded that the legal status of a bond security agent in the Czech legal system is relatively well regulated by the statutory regulation in the

Czech Act on Bonds. In contrast to the Slovak legal regulation, **Czech law** has several **advantages** and provides legal certainty to the parties involved, in particular for the following reasons:

1. The Czech law clearly provides that the bond security agent exercises all rights of the beneficiaries (i.e. not only the enforcement of the pledge) on their own behalf and for the benefit of the creditors.

2. It establishes an irrebuttable legal presumption that the bond security agent is to be treated as if they were the creditor of each secured claim.

3. It expressly provides that the bond security agent shall be registered in the public registers as a pledgee, even if they are not *de iure* a pledgee.

4. The Czech law clearly sets up the mechanism by which the performance that the bond security agent receives from the security is attributable to the individual creditors.

5. The Czech law avoids inconsistencies in the actions of the bondholders and the bond security agent by providing that, to the extent the security agent exercises rights with regard to the security of the bonds, the bondholders may not exercise such rights independently.

6. It provides for a change in the position of the bond security agent by providing that, by a resolution of the meeting of bondholders, all rights and obligations are transferred from the original to the new security agent, and provides for an automated regime vis-à-vis the public registers, which is a sufficient precaution in case the original security agent is reluctant to provide cooperation to the new security agent (the new security agent is entitled to apply for the registration of the change).

7. It allows the choice of a security agent regime under the Czech Act on Bonds for other cases where such a regime could be beneficial (e.g. syndicated loans).

The **shortcomings** of the Czech legal regulation of bond security agents are as follows:

1. It does not explicitly state when the bond security agent is obliged to pay the performance obtained as a result of exercising of the security among the individual bondholders (only their ratio is set, which is to be governed by the bond prospectus). In comparison, under common law trust regulation this issue is normally dealt with in an indenture or trust deed.

2. It is not expressly provided that acts already performed by the bond security agent are binding on the bondholders (although the bondholders cannot exercise their rights independently), which may be a problem where the security agent is dismissed but no successor is appointed and some bondholders wish to reverse the acts already performed. This issue is addressed by the trust law in common law countries and is also regulated by the Model Law on Secured Transactions (Article 16.5).

3. It does not expressly address the issue that even when a bond is transferred to another creditor, the bond security agent also has that status against that

creditor and that acts already performed by the security agent prior to the transfer are also effective against the new bondholder. The Model Law on Secured Transactions regulates this issue in Article 16.7.

4. The question of when the termination of the bond security agent is effective against third parties is not addressed. This question is addressed not only by the Anglo-American trust law but also by the Model Law on Secured Transactions. According to its Article 16.6 this termination becomes effective against a third party at the time when they have actual knowledge of the termination or, if they do not have such knowledge, at the time when the termination is registered.

5. The credit risk of a bond security agent that is neither a bank nor a securities broker is not addressed. The separation of the trustee's (agent´s) assets from those of the beneficiary and settlor in common law states derives from the very nature of the trust.

6. The issue of liability of the bond security agent is not explicitly addressed. In the common law systems trust deeds are typically drafted to exclude any liability for the trustee arising from a breach by it of their fiduciary duties or of the terms of the relevant trust deed, unless such breaches were committed fraudulently, in bad faith or with wilful default.[25]

7. Czech legislation does not address the conflict of interest of a bond security agent that:

- on the one hand, has a contractual relationship with the issuer that has appointed them, pays their remuneration and covers their expenses, and at the same time
- on the other hand, carries out their activities for the benefit of creditors (bondholders) and potentially
- may also have a vested interest in the repayment of the bonds, as they may themselves own the bonds issued (indeed, they may even be obliged to own at least one such bond under certain contracts concluded with issuers).

In the common law countries, unlike the Czech Republic and Slovak Republic, the conflict of interest of a bond trustee is precisely regulated. Should an actual conflict of interest appear, the bond trustee could deal with it in one of four ways[26]:

a) resign from their position,

b) get bondholder consent to relevant acts,

c) appoint an additional trustee to perform the part of the role which is giving rise to the conflict,

d) delegate all or part of their role to escape the conflict situation.

Of course, some of these issues can be addressed in the contract between the issuer and the bond security agent, the pledge agreement or the bond prospectus, given the default nature of the provisions of the Czech Act on Bonds. How-

[25] ICMA-NAFMII Working Group: op. cit., p. 16.
[26] Ibid, p. 36.

ever, this requires very good drafting skills and foresight on the side of the lawyers drafting the relevant documentation. Additionally, certain issues can only be regulated by the mandatory legal provisions applicable to bonds. Neither the Ministry of Finance nor the Czech National Bank have practical background to propose efficient amendments to the applicable laws without reflecting the requirements and needs of practice which should be reflected in the legislative procedure.

The significant gaps in the **Slovak legislation** result not only in the fact that most of the shortcomings mentioned above also apply thereto, but also that the advantages of the Czech legislation are at the same time **disadvantages** of the Slovak legislation. However, there are also several **advantages** due to the application of the commission agent regime to a bond security agent by analogy, e.g.:

- determination of the time frame for the performance obtained from the security by the bond security agent for the benefit of the bondholders (which eliminates the disadvantage of the Czech regulation sub 1.) or
- the absence of credit risk of the bond security agent (which eliminates the disadvantage of the Czech regulation sub 5.).

However, the above opinion is only a matter of interpretation of legal rules by analogy, which has not undergone any judicial review, therefore an explicit legal regulation of the bond security agent with all their rights and obligations as well as the consequences of its actions towards third parties is more than desirable.

## CONCLUSION

The legal regime of a bond security agent has been included in the Czech and Slovak legal order based on the practical needs. However, it is a foreign legal institution, derived from common law, which had to be adapted to domestic legislation and circumstances. This has been done to a large extent in the Czech Republic. It should be particularly appreciated that the Czech legislation has attempted to define this institute theoretically in relation to other similar institutes such as the commission relationship, trust fund or administration of the property of another. From a practical point of view, it can be stated that the Czech regulation on the bond security agent is modern, of high quality and meets the needs of practice. However, we have identified several proposals for its supplementation that may improve this legal institution.

The Slovak legislation is very lacunary and too general. Although it explicitly allows for the institute of a bond security agent, it regulates this legal institution only in one provision, without any theoretical definition and leaves open a number of practical questions. However, the needs of practice in relation to secured bond issues call for the swift adoption of comprehensive legal regulation. Indeed, there are fundamental limits to substituting the relevant legislation by contractual documentation or bond prospectus.

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# SECTION II
# COMPETITION LAW

# Slovak national regime of the protection against anticompetitive interventions by public authorities

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***Abstract:*** *The Slovak Act on the Protection of Competition prohibits the public authorities from restricting competition by providing evident support giving advantage to certain entrepreneurs, or in any other manner. This national regime of protection against anticompetitive interventions by public authorities evolves alongside the European one. The issue of a normative administrative act, the issue of an individual administrative act (or failure to issue such act, where it should have been issued), adoption of decision by a representative body or conclusion of a contract were identified as vectors of unlawful intervention into competition. The creation of a situation of inequality of income, costs or obligations of undertakings (or tolerating such situation), the creation of barriers to the participation in the market or giving advantage to certain undertakings in their competitive or supplier/customer relations were declared as having anticompetitive effect.*

***Keywords:*** *Act on the Protection of Competition, anticompetitive interventions by public authorities, the Antimonopoly Office of the Slovak Republic*.

## INTRODUCTION

Slovak competition law regulates not only obligations addressed to the undertakings (prohibition of anti-competitive agreements, prohibition of abuse of a dominant position and control of concentrations), but also obligations addressed to public authorities. Under Article 39 of the Act no. 136/2001 Coll. on the protection of competition (hereinafter **"**APC**"**): "*State administration authorities in the exercise of state administration, municipalities and self-governing regions in the exercise of self-governance and transferred state administration, and professional self-governance bodies in the exercise of transferred state administration must not provide evident support giving advantage to certain undertakings or otherwise restrict competition*."[1]

The quoted prohibition of a restriction of competition by public authorities is a prohibition of national origin, which evolves alongside the obligations of the Slovak Republic as a Member State of the European Union in the area of the protection of competition, that are of European origin (state aid, granting and exercise of exclusive or special rights by an undertaking, anticompetitive public

[1] The new SLOVAK REPUBLIC Act No. 187/2021 Coll., Act on the Protection of Competition [zákon č. 187/2021 Z. z. o ochrane hospodárskej súťaže], which in Article 6 took over the wording of Article 39 of APC, entered into force on 1 June 2021.

regulation of the market). Unlike the aforementioned obligations under European law a violation of Article 39 of APC is not conditional on an affectation of trade between the Member States.

Due to the brevity and generality of Article 39 of APC the decision-making practice of the Antimonopoly Office of the Slovak Republic (hereinafter **"**Office**"**) and the Council of the Office (which decides on the appeals lodged against first-instance decisions of the Office) and case-law of the Regional Court in Bratislava and the Supreme Court of the Slovak Republic (which perform the judicial review of decisions of the Council of the Office)[2] became the decisive source of positive law for its application.

Slovak or Czech law literature already addressed these typologically defined obligations of the Member States in the area of protection of the competition[3], but Article 39 of APC is covered by the legal doctrine very sporadically[4].

The aim of this paper is to provide the reader with a concise, systematically structured overview of the state of objective law in the area of application of Article 39 of APC. In the first step we will present the admissible vectors of violation of this provision and in the second step we will analyse the most frequently identified anti-competitive consequences of interventions of the public authorities.

## 1. INSTRUMENTS OF INTERVENTION OF PUBLIC AUTHORITIES INTO COMPETITION

Article 39 of APC only applies to state authorities (central and local government), self-governing authorities (municipalities, cities, higher territorial units) and professional self-government authorities (mostly professional associations to which a special act conferred a regulatory/disciplinary power over its members).

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[2] ŠRAMELOVÁ, Silvia, ŠUPÁKOVÁ, Andrea. Development of the judicial review of the decisions of the antimonopoly office of the slovak republic. Yearbook of Antitrust and Regulatory Studies. 2012, 5(7), 105–123.

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[4] LAPŠANSKÝ, Lukáš. Typy zásahov orgánov verejnej moci do hospodárskej súťaže podľa článku 39 zákona o ochrane hospodárskej súťaže. Právny obzor. 2012, 95 (6), 567-583.

Article 39 of APC only applies to the acts of public authorities, that serve for the exercise of state administration (the original exercise or the exercise transferred to local or professional self-government) or local self-government. It does not apply to the acts, by which public authorities fulfil other purpose, such as satisfaction of own operational needs.

### 1.1. Normative administrative acts

Instruments of intervention of public authorities into competition were often normative administrative acts, that are an expression of the legislative work of public authorities, with content and form of by-laws[5], such as decrees, ordinances, measures issued by the state authorities, but also generally binding regulations issued by the municipalities and cities.

In case of a *generally binding regulation of the city of Zvolen, relating to the binding part of the urban development plan of Zvolen – part Energy*[6], the competition authorities concluded that the city of Zvolen had violated Article 39 of APC by issuing a generally binding regulation relating to the binding part of the urban development plan of Zvolen in part Energy. In this regulation they provided that in heat supply to its development areas the city must prioritise the connection to the central heat source there where optimal territorial and technical conditions for this solution exist and avoid creating of new small sources of air pollution, in so far as the objects are connected to the central heat supply system.

So-called internal normative acts, such as instructions or guidelines, have legal effects that do not reach beyond the sphere of public administration, but instead remain limited to a group of authorites or entities, over which the authority issuing the internal normative act exercises a controlling power[7].

The Office also declared as unlawful the *instruction of the Ministry of Health of the Slovak Republic from 1998, addressed to the Social Insurance Company*, not to accept healthcare forms from the company IGAZ, but to only accept forms of the company ŠEVT. The Social Insurance Company later forwarded this instruction to the contractual health care facilities.[8]

### 1.2. Issue or non-issue of an individual administrative act

In the case of *a dissenting opinion of Bratislava – city district of Nové*

[5] ŠKULTÉTY, Peter, ANDOROVÁ, Petra, TÓTH, Jozef. *Správne právo hmotné. Všeobecná časť*. Šamorín: Heuréka, 2012, pp. 108-109.
[6] Decision of the Office of 21 July 2006, No. 2006/39/2/1/087. [accessed on 2021-09-27]. Available from: https://www.antimon.gov.sk/0063921087.
[7] MACHAJOVÁ, Jozefína et al. *Všeobecné správne právo*. Bratislava: Eurokódex, 2012, p. 184.
[8] Previously available on: https://www.antimon.gov.sk/publik_c/1999/AG_feb99.html.

*mesto to the location of a pharmacy in the building of the Outpatient Clinic Tehelná*[9] the Office subsumed under Article 39 of APC the issue of a binding negative opinion of the city district to the plan to locate a pharmacy in the building of the Outpatient Clinic Tehelná. The Office reasoned that the outpatient clinic already had a well-functioning pharmacy, which together with other pharmacies situated in the proximity of the outpatient clinic provided sufficient healthcare services to the citizens living in the area.

In the case of *breakdown of budget allocation of the Ministry of Culture of the Slovak Republic for the Press Agency of the Slovak Republic for the year 2005*[10] the Office assessed the act of breaking down of the binding indicators of budget allocation, which the founder provides to the founded organisation, i.e., an act classified as individual financial-legal act of constituting nature, which establishes, changes or terminates concrete financial-legal relations[11].

In the case of *failure to enforce a generally binding regulation of the city of Levoča relating to the fee from sale of alcoholic beverages and tobacco products*[12] the Office assessed a situation where the city of Levoča had tolerated a situation where one third of undertakings, that were obliged to pay a fee from sale of alcoholic beverages and tobacco products, did not do so. The reason for violation of Article 39 of APC in this case was the failure to issue a payment notice to the undertakings that had failed to pay this fee.

In the case of *favouring of the Bratislava subsidised organisation Marianum I*[13] the vector of violation of Article 39 of APC was the decision of the Municipal Council of Bratislava that the performance of cemetery and crematorium services on the burial sites, owned by the city of Bratislava and administered by the municipal organisation Marianum, will remain in competence of Marianum and that private funeral homes can perform all funeral services, including the transport of the deceased, but without the possibility to provide commercial services on the burial sites owned by the city of Bratislava. As APC penalises each (real or potential) restriction of competition, Article 39 of APC was violated already when the decision of the Municipal Council allowed for an anticompetitive conduct of *Marianum*; whether Marianum was engaged in an anticompetitive conduct as well, is irrelevant in this case.

The Office was confronted with cases of contracts, by which public authorities had exercised or performed different powers or obligations granted or imposed on them by law. In the case of *contracts on the lease of land for installation*

[9] Decision of the Office of 9 October 2007, No. 2007/39/1/1/083. [accessed on 2021-09-27]. Available from: https://www.antimon.gov.sk/20073911083/.
[10] Decision of the Office of 28 February 2005, No. 2005/39/2/111. [accessed on 2021-09-27]. Available from: https://www.antimon.gov.sk/20053921111/.
[11] BABČÁK, Vladimír et al. *Finančné právo na Slovensku a v Európskej únii*. Bratislava: Eurokódex, 2012, p. 96.
[12] The 1993 Annual Report of the Office.
[13] Decision of the Office of 29 September 2008, No. 2008/39/2/1/079. [accessed on 2021-09-27]. Available from: https://www.antimon.gov.sk/20083921079/.

*of a news-stand, concluded by the city of Kysucké Nové Mesto,*[14] the instrument of violation of Article 39 of APC were contracts on the lease of municipal land, which the city had leased to the lessee for installation of a news-stand. The city in these contracts pledged not to lease other municipal land, situated less than 400 metres from land leased under the lease contract, to other lessee for the same or similar purpose. By concluding these lease contracts, the city fulfilled its legal obligation to execute acts related to diligent management of municipal property, therefore their conclusion could be assessed in terms of Article 39 of APC.

## 2. ANTICOMPETITIVE EFFECTS OF INTERVENTIONS OF PUBLIC AUTHORITIES

In assessing the conduct of public authorities in terms of Article 39 of APC the definition of a relevant market need not be as thorough as for the "classic" agendas of antimonopoly law. Even if the circumstances of the case justified the definition of a narrower relevant market, the Office often settles for definition of a wider relevant market, when it establishes the presence of a competitor of an unduly favoured undertaking even on such widely defined relevant market.

### 2.1. Creating a situation of inequality of income, costs or obligations of undertakings or tolerating such situation

In the mentioned case of *failure to enforce a generally binding regulation of the city of Levoča relating to the fee from the sale of alcoholic beverages and tobacco products* by tolerating a situation, where one third of undertakings obliged to pay the fee failed to do so, the city restricted competition by discriminating the undertakings that paid the fee.

In the mentioned case of *breakdown of budget allocation of the Ministry of Culture of the Slovak Republic for the News Agency of the Slovak Republic for the year 2005* the Office found that the Ministry of Culture had allowed a portion of budget allocation for the News Agency of the Slovak Republic (hereinafter **"**NASR**"**) for the year 2005, earmarked for current expenditure, to be used also for running of the editorial offices, whose outputs competed with outputs of the private press agency SITA, which financed costs of its operations exclusively from its own sources. The Ministry of Culture thus distorted competition by allowing NASR to use the funds from this budget allocation for the financing of services provided in a competitive environment, which put the undertaking SITA at competitive disadvantage.

[14] Decision of the Office of 4 April 2005, No. 2005/KV/1/1/043.

### 2.2. Creation of barriers to market participation

In the mentioned case of *a dissenting opinion of Bratislava – city district Nové mesto to the location of a pharmacy in the building of the Outpatient Clinic Tehelná* the Office concluded that the issue of a dissenting opinion with the reasons mentioned above had restricted competition on the relevant market of provision of health care services in public pharmacies in the catchment area of Bratislava – Nové Mesto by the clear support of undertakings that already provided health care services in public pharmacies in this catchment area.

In the mentioned case of *favouring of the Bratislava subsidised organisation Marianum I* the Office examined the position of the municipal organisation Marianum:

a) on the market of cemetery services and cremation services (services that are directly related to the operation of a cemetery or crematorium and provided exclusively by the cemetery or crematorium operators), where Marianum held a monopoly, because it was the sole operator of the cemeteries and the crematorium in Bratislava, and

b) on the market of funeral services (all activities related to the preparation of human remains for burial and to the provision of the memorial service, with some being performed outside the burial site or crematorium and some being performed directly on the burial site or in the crematorium), where Marianum was in a competitive relationship with other providers of funeral services in Bratislava.

In this context, the decision of the Municipal Council of Bratislava, which had deprived other funeral service providers of the possibility to provide funeral services, performed directly on the cemeteries and in the crematorium, on the cemeteries and in the crematorium operated by Marianum, made it much more difficult for these other providers to gain access to the funeral service market and thus favoured Marianum.

### 2.3. Favouring of an undertaking in its competitive relations

In the mentioned case of *instruction of the Ministry of Health of the Slovak Republic from 1998, addressed to the Social Insurance Company*, the Ministry of Health instructed the Social Insurance Company not to accept healthcare forms from the company IGAZ, but to only accept forms of the company ŠEVT, in a situation where healthcare forms were conveniently printed and supplied by several undertakings (not only by ŠEVT and IGAZ). By issuing this instruction the Ministry clearly favoured the company ŠEVT over its competitors.

### 2.4. Favouring of an undertaking in its supplier-customer relations

In the case of *favouring of the Bratislava subsidised organisation Marianum II*[15] the pricelist of works and services provided by Marianum on burial sites owned by the city of Bratislava (which was approved by the Municipal Council of Bratislava) regulated among others the fee for liquidation of a grave (urn) monument (hereinafter **"**fee for liquidation of a monument**"**). The fee for liquidation of monument should have been paid by the applicant for a burial plot that was cancelled at the time of submission of the application, but the original beneficiary had not removed the accessories of the burial plot. According to the operating rules the cemetery operator is obliged to set up burial plots and if the beneficiary does not remove the accessories of the burial plot after its cancellation at his own expense, such obligation will be transferred to the cemetery operator, who can later recover the costs associated with such removal from the beneficiary. By approval of the pricelist containing the fee for liquidation of a monument the city of Bratislava allowed the cemetery operator to transfer to the applicants for burial plots on the cemeteries, where no vacant burial plots without monuments are available, the costs of liquidation of monuments of the original beneficiaries, although these costs should have been borne by these original beneficiaries or the cemetery operator, and thus to unduly burden the new beneficiaries.

## CONCLUSION

In the case of anticompetitive interventions of public authorities, the Office is empowered to issue a decision stating a violation of the law, a decision imposing the obligation to refrain from any unlawful conduct and to regularise the situation, as well as a decision imposing a fine up to EUR 66,000.

The body of decisions stating a violation of Article 39 of APC in the period of years 2004 to 2009, many of which had landed before the Supreme Court, and the increase of the upper limit of the fine for a violation of Article 39 of APC up to EUR 66,000 probably contributed to elimination of the most evident anticompetitive conducts of public authorities, because the last two cases of application of Article 39 of APC by the Office date back to 2014 and 2019, respectively.

[15] Decision of the Office of 18 November 2008, No. 2008/39/2/1/097. [accessed on 2021-09-27]. Available from: https://www.antimon.gov.sk/20083921097/; The Supreme Court of the Slovak Republic cancelled for the formal reason this decision of the Office by judgment of 6 April 2011, No. 2Sžh 1/2010. [accessed on 2021-09-27]. Available from: https://www.antimon.gov.sk/data/att/920.pdf.

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# ‘Gun Jumping’ in the merger implementation in the EU in light of the Altice Case

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***Abstract:*** *The paper analyses the scope of the gun jumping prohibition in light of the judgment of the General Court in the Altice case (T-425/18). After introducing the facts of the case, it dives into the legal issues raised. It concentrates on the main areas of concern – the scope of Article 4(1) and 7(1) of the EU Merger Regulation, the pre-closing covenants in the transaction documentation and the exchange of information. The paper identifies four important implications of the Altice case. First, the case confirms that concurrent violation of notification and standstill obligation is possible. Second, it provides clearer guidance as to which pre-closing covenants may be regarded as granting the acquirer a possibility of exercising control over the target. Third, it confirms that a concentration may be implemented by pre-closing covenants regardless of their actual implementation. Finally, it makes clear that excessive information exchange may support the finding of decisive influence.*

***Keywords:*** *competition law, gun jumping, M&A, EU Merger Regulation, information exchange.*

## INTRODUCTION

The EU merger law prevents undertakings from implementing some mergers until the European Commission (Commission) has reviewed and confirmed their compatibility with the internal market. The undertakings are required to behave independently and operate as separate business units until the Commission grants formal approval. To comply with this *ex ante* control regime, they are required to (i) notify their transaction “*prior to the implementation and following the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest*” (Article 4(1) of the European Union Merger Regulation (EUMR))[1] (the notification obligation), and (ii) refrain from implementing the concentration “*before its notification or until it has been declared compatible*” with the internal market by a Commission decision (Article 7(1) of the EUMR (the standstill obligation). The failure to comply with either or both

[1] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32004R0139.

of those obligations is considered gun jumping.[2]

The aim of those obligations is to prevent mergers that may have adverse effects on competition which could prove to be irreversible. Although mergers may be evaluated *ex post* when they amount to anti-competitive agreement prohibited by Article 101 Treaty on the Functioning of the European Union[3] (TFEU) or lead to market dominance whose abuse is prohibited by Article 102 TFEU, it is recognized that *ex ante* control which prevents such potential negative effects may be more effective.[4]

On 22 September 2021, the General Court of the European Union (GC) upheld the decision of the Commission which imposed two fines on Altice Europe (Altice) for gun jumping related to its acquisition of PT Portugal (PT).[5] The decision clarifies the scope of gun jumping prohibition in the EU and portends a strict approach to those offences in the EU.

This paper examines how to read the prohibition of gun jumping in light of the Altice case. It first briefly describes the background and facts of the case. It then moves to evaluate the legal issues raised. Finally, it describes its implications for notifiable M&A transactions and suggests precautionary measures the entities involved in such transactions may wish to adopt to ensure they are not found to engage in gun jumping. Rather than providing a theoretical delineation of the underlying legal concepts, the paper, as a case note, focuses on practical aspects of undertaking economic concentrations relevant for both businesses and their legal representatives.

## 1. BACKGROUND AND FACTS OF ALTICE CASE

Altice is a multinational cable and telecommunications company based

[2] See, e.g., BOYCE, John and LYLE-SMYTHE, Anna. Merger Control. In: BAILEY, David and JOHN, Laura Elizabeth (eds). *Bellamy & Child: European Union Law of Competition*. London: Oxford University Press, 2018, 594-772. 9780198794752, at para. 8.141, or VAN BAEL, Ivo, and BELLIS, Jean-Francois (ed). Chapter 7: Control of Mergers, Acquisitions and Certain Joint Ventures. In: VAN BAEL, Ivo, and BELLIS, Jean-Francois (ed). *Competition Law of the European Union (Sixth Edition)*, Kluwer Law International, 2021, 663 – 798. 9789041153982, at 771.

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[4] KINDL, Jiří et al. *Soutěžní právo*. Praha: C. H. Beck, 2021, 1016. 978-80-7400-806-1, at 539.

[5] Judgment of the General Court of 22 September 2021. Altice Europe NV v European Commission. Case T-425/18 [online]. In EUR-Lex. [accessed on 2021-10-03]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62018TJ0425 (Altice decision).

in the Netherlands.[6] PT is an important telecommunications and multimedia operator in Portugal.[7] On 9 December 2014, Altice and Oi (a Brazilian telecom operator owning PT) entered into a share purchase agreement (SPA) whereby Altice agreed to purchase the entire share capital of PT from Oi.[8] The SPA contained several covenants which determined how PT's business was to be conducted between the signing of the SPA and closing of the transaction following approval by the Commission.

Altice formally notified the transaction to the Commission in February 2015.[9] In April 2015, the Commission declared the acquisition compatible with the internal market subject to adoption of commitments,[10] and on 2 June 2015 Altice publicly announced that it had closed the transaction (i.e., that the ownership of the shares in PT had been transferred to it).[11]

Yet, in March 2016, the Commission gained suspicion that despite formally notifying the transaction and being granted approval, Altice might have infringed the notification and/or standstill obligation by exercising decisive influence over PT before receiving the approval.[12] The investigation corroborated this suspicion. The Commission concluded that Altice implemented the transaction prior to notification and prior to receiving the Commission's approval and imposed a fine totalling €124.5 million on Altice.[13] The SPA allegedly granted Altice the power to exercise decisive influence over PT's ordinary businesses and Altice actually exercised such influence in several instances. The excessive information exchange between Altice and PT also allegedly contributed to the exercise of such decisive influence.[14]

Altice sought the annulment of the Commission's decision before the GC. It denied the allegations that its actions amounted to a lasting change of control before notification or approval and argued that the Commission sanctioned it for the conduct that was preparatory or ancillary to the transaction.[15] The GC

[6] Decision of the Commission of 24 April 2018. Altice/PT Portugal. Case M.7993 [online]. In EC.Europea.eu. [accessed on 2021-10-03]. Available from: https://ec.europa.eu/competition/mergers/cases/decisions/m7993_849_3.pdf (Commission's decision), para. 1.
[7] Commission's decision, para. 2.
[8] Commission's decision, para. 3.
[9] Commission's decision, para. 7.
[10] Commission's decision, para. 10.
[11] Commission's decision, para. 11.
[12] Commission's decision, para. 16. This was based on press reports that informed about meetings of Altice's and PT's executives in February and March 2015.
[13] Commission's decision, article 3 and 4 of the operative part.
[14] See also EUROPEAN COMMISSION. Mergers: Commission fines Altice €125 million for breaching EU rules and controlling PT Portugal before obtaining merger approval. European Commission [online]. 2018 [viewed 03 October 2021]. Available from: https://ec.europa.eu/commission/presscorner/detail/en/IP_18_3522.
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largely dismissed those claims and upheld the Commission's decision. The section below provides a summary of the main legal issues that the GC considered.

## 2. LEGAL ISSUES IN THE ALTICE DECISION

### 2.1. The scope of Articles 4(1) and 7(1) EUMR

First, the GC supported the possibility of holding a company responsible for the infringement of both the notification and standstill obligation for the same conduct.

Altice claimed it was unlawfully fined twice for the same conduct as breach of notification obligation necessarily results in breach of the standstill obligation.[16] The GC dismissed this claim by pointing out that those obligations pursue autonomous objectives in the context of the "one-stop shop" EU merger system.[17] It noted that while the infringement of notification obligation automatically results in an infringement of standstill obligation, the opposite is not true.[18] The undertaking can infringe standstill obligation without necessarily infringing notification obligation. This may be the case where it notifies the concentration but implements it before the Commission declares it compatible with the internal market.[19] It also pointed out that whereas the notification obligation is an obligation to act and its violation constitutes an instantaneous infringement, the standstill obligation is an obligation not to act and its infringement constitutes a continuous infringement.[20] Finally, the CG highlighted that if it was not able to distinguish between the violation of notification obligation and standstill obligation, the effective control of concentrations in the EU would be frustrated as the notification obligation could never be the subject of a specific penalty.[21]

### 2.2. Veto rights in the SPA

Second, the GC clarified the scope of the standstill obligation by holding that some clauses in the transaction documentation which concern the business operation of the target between signing and closing may be considered as giving the acquirer a possibility exercising control over the target.

Altice contested the Commission's conclusion that the veto rights

[16] Altice decision, para. 51. In the Commission's decision, the Commission considered the breach of those obligations as two different infringements each giving rise to separate fines of €62.25 million.
[17] Altice decision, para. 56.
[18] Altice decision, para. 54. See also Judgment of the General court of 26 October 2017. Marine Harvest v Commission. Case T-704/14 [online]. In EUR-Lex. [accessed on 2021-10-03]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62014TJ0704, para. 302.
[19] Altice decision, para. 55.
[20] Altice decision, para. 57 and 58.
[21] Altice decision, para. 63.

granted to it in the SPA gave it control over PT. It argued that those rights were necessary to conserve the integrity of commercial activities of PT between signing and closing and thus needed to be considered ancillary or preparatory to the transaction.

The GC examined the respective SPA covenants and concurred with the Commission that Altice had not proved that the covenants were necessary to preserve the value of PT's business or to avoid PT's commercial integrity from being compromised.[22]

First, it concurred with the Commission that having the right to oversee the personnel of the target between the signing and closing may be justified to preserve the value in relation to certain key employees who are integral to the value of the business.[23] The powers related to appointment, dismissal and changes of employees or officers granted to Altice by the SPA were however too broad when they related to personnel that was not likely to be relevant to the value of PT's business.[24]

Second, the GC upheld the Commission's view that the covenants related to PT's pricing policy were so wide as to effectively require that Altice consents to any change in PT's prices. Similarly, the covenants entitling Altice to enter into, terminate or modify certain types of contracts which PT could conclude prior to the closing of the acquisition, were extremely broad, especially given the commercial matters covered by those clauses and the low level of monetary thresholds applicable.

Given that the covenants clearly exceeded what would be necessary to preserve the value of business or commercial integrity, the GC thus concluded that the covenants granted Altice the possibility to exercise control over PT.[25]

### 2.3. Meaning of "possibility of exercising decisive influence" and "implementation of control"

Third, the GC clarified that a mere possibility that the clauses give an acquirer the power to exercise decisive influence over the target suffices to constitute an infringement of the notification and/or standstill obligation.

Altice argued that Articles 7(1) and 4(1) of the EUMR do not prohibit agreements which give the possibility of exercising decisive influence on another undertaking, but only prohibit implementation of control on a lasting basis.[26] It

[22] Altice decision, para. 92.
[23] Altice decision, para. 110.
[24] Altice decision, paras. 110-114.
[25] Altice decision, para. 117 and 131.
[26] Altice decision, para. 70. It claimed that the Commission violated the principle of legality by interpreting the notion of "implementation" as requiring a mere "possibility of exercising decisive influence".

claimed that the acquisition of control and therefore also the possibility of exercising decisive influence on a lasting basis must be *implemented* in order to infringe the EUMR.

The GC rejected that argument by explaining that the key to the assessment of whether the transaction has been implemented is considering whether there has been a change of control on a lasting basis. Such control is constituted by the possibility of exercising decisive influence over the target.[27] This is particularly the case where the acquirer is able to impose choices on the target in relation to its strategic decisions.[28]

The GC observed that the SPA was effective before the transaction was notified to the Commission. As the SPA gave Altice the possibility of exercising decisive influence over PT and its clauses applied immediately, the signing of the SPA marked the implementation of the transaction, regardless of whether Altice exercised decisive influence or not.[29]

In addition, the GC inferred from the facts of the case that decisive influence was actually exercised on certain aspects of PT's business before closing of the transaction, by intervening in PT's day-to-day operations and by exchanging competitively and sensitive information between PT and Altice (see below).[30]

### 2.4. Scope of legitimate information exchange

Finally, the GC clarified the scope of information that may be exchanged in the M&A transactions.

Altice posited that the information exchanges that occurred between Altice and PT were inevitable and even necessary in the context of the transaction, and as such were inefficient to establish an infringement of the notification and standstill obligations.[31]

The GC rejected this argument. It concurred with the Commission in that although exchanges of business-related information between a potential acquirer and a vendor could be considered as a normal part of the acquisition process, this is only where the nature and purpose of such exchanges are directly related to the potential acquirer's need to assess the value of the acquired business.[32] The GC found that the exchanges in the present case went beyond this need. It pointed out that the exchanges of information continued after signing of the SPA, which in-

[27] Altice decision, para. 173. See also the EUMR, Article 3(2): "*Control shall be constituted by rights, contacts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking (...)*".
[28] Altice decision, para. 84.
[29] Altice decision, para. 132.
[30] Altice decision, para. 174.
[31] Altice decision, para. 219.
[32] Commission's decision, para. 437. Altice decision, para. 229.

dicates they were not simply for the purpose of value assessment. It also highlighted the competitive relationship between Altice and PT, when some of Altice's subsidiaries were in direct competition with PT at that time.[33] The granularity of the information also contributed to the exchange being regarded as going beyond the need to assess the value of PT's business. The parties were found to exchange detailed information on matters such as key initiatives in terms of strategy and commercial objectives, cost-related strategies, key supplier relationships, recent financial data on revenues, profit margins, or various planning data,[34] or in relation to future pricing strategy.[35] It also pointed out that these exchanges took place outside any confidentiality agreement.

The GC concluded that these exchanges contributed to finding that Altice had exercised decisive influence over certain aspects of PT's business.[36]

## 3. IMPLICATIONS OF THE ALTICE DECISION

### 3.1. Concurrent violation of notification and standstill obligation is possible

First, the Altice decision confirms that when the parties implement their transaction before its clearance by the Commission, they risk being fined for violating both the notification and standstill obligation.[37] This reasoning is in line with the approach of the Court of Justice (CJEU) in the *Marine Harvest* case,[38] which was rendered during the proceedings before the GC in the Altice case. In that case, the CJEU did not concur with an alternative view that where the same conduct is caught by more than one statutory provision, but one of those provisions is more specific than the other, only the more specific one must be applied.[39]

[33] Altice decision, para. 230.
[34] Altice decision, para. 223.
[35] Altice decision, para. 224.
[36] Altice decision, para. 235.
[37] Opi, Sergio Baches, and Boitos, Adela. Gun Jumping in the European Union: An Analysis in Light of Ernst & Young. Journal of European Competition Law & Practice. 2019, 10(5), 269 – 280, at 269.
[38] Judgment of the Court of 4 March 2020. Marine Harvest v Commission. Case C-10/18P [online]. In EUR-Lex. [accessed on 2021-10-03]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62018CA0010 (CJEU Marine Harvest decision). See also Kiehl, Philippe. Mowi v Commission: Gun Jumping – Don't Wag the Merger Control Dog. Journal of European Competition Law & Practice. 2020, 11(5-6), 257-259, at 258.
[39] CJEU Marine Harvest decision, para. 112-116, and the Opinion of Advocate General Tanchev delivered on 26 September 2019. Marine Harvest v Commission. Case C-10/18 P [online]. In EUR-Lex. [accessed on 2021-10-03]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62018CC0010&qid=1633274956132.

### 3.2. Unreasonable pre-closing covenants may be regarded as granting the acquirer the possibility of exercising control over the target

Second, the Altice decision makes clear that concentration may be implemented by contractual covenants which grant the acquirer the possibility of exercising control over the target, by conferring on it the possibility of exercising decisive influence over its business. It is irrelevant whether those covenants were actually relied on or whether they resulted in actual control. This provides yet another specification to the general rule enunciated by the CJEU in the *Ernst & Young* case.[40] In that case, the CJEU held that a measure taken in preparation of a concentration falls outside the scope of the standstill obligation if, in spite of its market effects, it does not contribute to a lasting change of control.[41] Only the conduct that materially contributes to the change of control is prohibited as gun jumping.[42] Following these instructions, the GC noted in the Altice case that it is not necessary to determine whether a preparatory measure constitutes an ancillary restriction (as Altice argued).[43] Rather, what is crucial is whether that measure contributes to the change of control of the target.[44] This is why the GC dismissed that control on a lasting basis was established solely by the transfer of shares, but rather examined the possibility the SPA gave to Altice to exercise decisive influence over PT before clearance.[45]

While it has been clear even before the Altice decision that an acquirer cannot control, influence, or determine competitive behaviour of the target prior to clearance,[46] the Altice decision clarifies what measures applicable between signing and closing go beyond the value preservation purposes and amount to the exercise of control. These are particularly broad veto rights that give the acquirer control over personnel that is not key for value preservation, or that entitle the acquirer to give prior approval to all material contracts and investments and

[40] Judgment of the Court of 31 May 2018. Ernst & Young P/S v Konkurrencerådet. C-633/16 [online]. In EUR-Lex. [accessed on 2021-10-03]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62016CJ0633 (Ernst & Young decision).
[41] Ernst & Young decision, para. 45-47 and 59.
[42] CASPARY, Tobias, and FLANDRIN, Julie. Ernst & Young: First Guidance on Gun-jumping at EU Level. Journal of European Competition Law & Practice. 2018, 9(8), 516-518, at 516.
[43] In that regard, the CG highlighted that the CJEU in the Ernst & Young decision did not exclude all ancillary or preparatory measures, as such, from the scope of Article 7(1) of the EUMR and did not consider it useful to have recourse to any criteria to establish the probable or preparatory nature of the measures in question. Altice decision, para. 99.
[44] Altice decision, para. 98.
[45] Altice decision, para. 77.
[46] KINDL, *supra* note 4 at 622. For general discussion see also BLUMENTHAL, William. The Scope of Permissible Coordination Between Merging Entities Prior to Consummation. Antitrust Law Journal. 1994, 63(1), 1-58.

thereby intervene in day-to-day business of the target.[47] It may be inferred that the value preservation measures should be limited to measures to ensure that the target refrains from unusual operations or substantial changes to its commercial activities that would lead to devaluing of the target's assets.[48]

### 3.3. Concentration may be implemented by pre-closing covenants regardless of their actual implementation

Third, the Altice decision confirms that a mere possibility to exercise decisive influence over the target is sufficient to constitute control pursuant to the EUMR. The fact that control does not have to be effectively used was suggested already in the *Marine Harvest* case, where the Commission opined that it is irrelevant whether the acquirer has, in fact, exercised voting rights that were conferred to it and at its disposal.[49] In the Altice case, such possibility was given simply by signing the SPA with the interim covenants.

### 3.4. Excessive information exchange may support the finding of exercise of control

Finally, the Altice decision highlighted that exchange of sensitive commercial information may be considered as contributing to finding a change of control on a lasting basis. That will be the case where the information allows or enables the acquirer to interfere in the business behaviour of the target. The context of the information exchange, detail and granularity of the information itself, its contents or frequency of the exchange will be relevant for finding that potential. The Altice decision suggests that whereas the exchange of some information may be justified in the due diligence period, continued exchange of the same information after signing may contribute to a change of control.[50]

This underscores the importance of a carefully crafted information shar-

[47] See also CASPAREY and FLANDRIN, *supra* note 42 at 518, or OPI and BOITOS, *supra* note 37 at 279.

[48] See also SILVA, Isabelle de. Reflections on gun jumping in mergers. *Concurrences* [online]. 2018, 3, 1-11. [viewed 03 October 2021]. Available from: https://www.concurrences.com/IMG/pdf/05.concurrences_3-2018_article_i._de_silva-en_1_.pdf?44333/eb088c66a067a090e1fa1237605016cbe99b5b10, at 7 or 9.

[49] Decision of the Commission of 23 July 2014. Marine Harvest/Morpol. Case COMP/M.7184 [online]. In EC.Europea.eu. [accessed on 2021-10-03]. Available from: https://ec.europa.eu/competition/mergers/cases/decisions/m7184_1048_2.pdf, para. 82. This was confirmed on appeal by the GC (Judgment of the General court of 26 October 2017. Marine Harvest v Commission. Case T-704/14 [online]. In EUR-Lex. [accessed on 2021-10-03]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62014TJ0704, para. 58-59, or para. 164) and by the CJEU (CJEU Marine Harvest decision, para. 63 and 64).

[50] Altice decision, para. 230.

ing framework in the M&A transactions. Rules limiting the scope, access or frequency are crucial.[51] Hence, the scope shall be limited to what is strictly necessary to valuate the target and to ensure that the value of the target is preserved. Also, the measures to reduce the strategic importance of the information may be recommended, such as aggregating the data or prohibiting sharing of forward-looking data. The access to sensitive information shall be limited by constituting "Chinese walls" and/or clean teams. The parties may either employ external advisors or rely on internal employees or members of management who do not have any customer facing or decision-making role in competitively sensitive issues (including strategy and pricing). In addition, the parties may require that those individuals do not hold any such role for some period from the date of the termination of transaction in case the transaction does not proceed for any reason. The members of such clean teams shall then use the information for the purposes of the evaluation and implementation of the transaction only. To cement those obligations, the members of clean teams may be required to sign a specific non-disclosure agreement and/or an agreement to otherwise recognize adherence to the rules of access to and handling of sensitive information.[52]

## CONCLUSION

The Altice decision provides a welcome guidance to companies as to what practices may constitute 'gun jumping', i.e., a partial implementation of a transaction after notification but prior to formal authorization. In particular, it clarifies where to draw a line between legitimate preparatory conduct and a partial implementation of a notified transaction. Post-Altice, it is clear that a mere possibility of exercising control over the target, granted by a SPA, can constitute a violation of the standstill obligation. Hence, interim covenants need to be drafted carefully not to go beyond what is necessary to preserve the target's value or protect its commercial integrity. Veto rights regarding senior management and day-to-day business strategy are notably suspicious. Moreover, an actual implementation of those clauses is not necessary for finding an infringement.

Albeit gun jumping has been commonly condemned in the US, enforcement against this practice in the EU has been rather scarce.[53] The Altice decision complements a series of decisions by the Commission and the CJEU that draw attention to this practice in the EU and with the record fine imposed it confirms a tough stance against it that has been signalled in recent statements.[54] Given the

[51] FERNÁNDEZ, Cani et al. Information Exchanges and the Due Diligence Process. Competition Law International. 2017, 13(1), 67-72, at 73.

[52] KINDL, *supra* note 4 at 622. See also generally GASSLER, Martin. *Information Exchange Between Competitors in EU Competition Law*. Kluwer Law International, 2021, 296. 9789403531830.

[53] LYLE-SMYTHE, Anna, and TINGLE, Jodie-Jane. Gun-Jumping Enforcement: A Comparative Analysis. Antitrust. 2017, 31(2), 37-43, at 37.

[54] See, e.g., EUROPEAN COMMISSION. Statement by Commissioner Vestager on three Statements of Objections sent to Merck and Sigma-Aldrich, to General Electric, and to Canon for breaching EU

unification of merger control regimes across the EU, national competition authorities in the EU will likely adopt a similar strict interpretation of standstill obligation in their national laws.

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# Pricing algorithms: are they threatening the competition?

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***Abstract:*** *The paper deals with pricing algorithms in the context of competition law. Antitrust authorities around the world are concerned about the fact that pricing algorithms with even relatively low level of sophistication tend to cooperate without specific instructions, what may lead to their tacit collusion challenging current antimonopoly regulation. Negative impact may be seen in prices set above the market level and suppressed competition which may bring damage to consumers. Current legislation is not prepared for such technological advancement. The paper provides an overview on possible solutions for taking autonomous pricing algorithms under control.*

***Keywords:*** *pricing algorithms, artificial intelligence, competition law, tacit collusion.*

## INTRODUCTION

This paper deals with the issue of pricing algorithms (hereinafter also "PA") and their impact on competition. With the emergence of advanced technologies and the development of artificial intelligence (hereinafter also "AI"), the risk of cooperation of two or more PA without being initially programmed to communicate is increasing. The literature points to this fact as well: researchers agree that under certain conditions algorithms can tacitly collude. At the same time, antitrust authorities around the world recognise that the current regulatory framework is not ready for the ongoing technological changes on the digital market. The aim of this paper is to assess the negative effects of pricing algorithms on competition and to try to suggest possible solutions for antitrust authorities while implementing control and investigative measures.

The issue represents a current direction of research in the academia: the behaviour of algorithms has been assessed in a series of experiments[1], where it has been shown that under certain conditions pricing algorithms generate cooperative strategies without explicit communication. Another subject of research is

[1] See e.g., WALTMAN, Ludo a Uzay KAYMAK. Q-learning agents in a Cournot oligopoly model. *Journal of Economic Dynamics and Control*. 2008, **32**(10), 3275-3293. ISSN 01651889. Available from: doi:10.1016/j.jedc.2008.01.003 or CALVANO, Emilio, Giacomo CALZOLARI, Vincenzo DENICOLÒ a Sergio PASTORELLO. Artificial Intelligence, Algorithmic Pricing, and Collusion. *American Economic Review*. 2020, 110(10), 3267-3297. ISSN 0002-8282. Available from: doi:10.1257/aer.20190623.

the architecture of algorithms and its effect on pricing strategy when algorithms interact[2]. At the same time, researchers are defining the necessary conditions to make the collusion possible.[3] Some authors address the issue of liability for breach of competition law as a result of the cooperation of PA by pointing out the gaps in the current legislation and suggesting possible responses by legislators[4]. In the Czech legal environment, the publication by prof. Bejček[5] on the impact of digitalization on the competition law is worth mentioning.

## 1. PRICING ALGORITMS

Modern world puts a lot of pressure on entrepreneurs, who in order to maintain their market position and strengthen the competitiveness must keep pace with the development of technology and continuously invest in digitalization and automatization of business processes. Today an incredible amount of data (big data) is generated every second. The global big data market is expected to grow by 18 % by 2025 compared to 2021.[6] Current and potential customers data, information on competitors' behaviour, price trends, stock levels and other facts that affect the financial performance of companies represent critically important value for entrepreneurs and their proper use brings competitive advantage. Pricing automatization can nowadays be considered as a necessity for business rather than a nice bonus.

Pricing algorithms can be defined as a software with a certain degree of intelligence which is used to collect, process and analyse big data coming from the market and the environment. Using this data PA instantly reacts to price movements, creates predictions of future market development and, most importantly, determines the pricing strategy for user. Furthermore, it evaluates the potential impact of changes on the market and sets prices to achieve its objective

[2] See e.g., ASKER, John and FERSHTMAN, Chaim and PAKES, Ariel, Artificial Intelligence and Pricing: The Impact of Algorithm Design (March 1, 2021). *CEPR Discussion Paper No. DP15880*, Available at SSRN: https://ssrn.com/abstract=3805295.

[3] See e.g., SALCEDO, Bruno. Pricing Algorithms and Tacit Collusion. Pennsylvania, 2015, 11.01.2015, 30. Available from: https://brunosalcedo.com/docs/collusion.pdf.

[4] See e.g. HARRINGTON, Joseph E. DEVELOPING COMPETITION LAW FOR COLLUSION BY AUTONOMOUS ARTIFICIAL AGENTS. *Journal of Competition Law and Economics*. Oxford University Press, 2018, **14**(3), 331-363. ISSN 1744-6414. Available from: doi:10.1093/joclec/nhy016 or EZRACHI, Ariel a Maurice E. STUCKE. *Virtual Competition: The Promise and Perils of the Algorithm-Driven Economy*. Cambridge: Harvard University Press, 2016. ISBN 978 0674545472 for the U.S. antitrust law.

[5] BEJČEK, Josef. O vlivu digitalizace na soutěžní právo – mnoho povyku pro nic? In: SUCHOŽA, Jozef, HUSÁR, Ján, HUČKOVÁ, Regina. Právo, obchod, ekonomika VIII. Košice: Univerzita P. J. Šafárika v Košiciach, 2017.

[6] The Global Big Data Market is expected to grow by $ 247.30 bn during 2021-2025, progressing at a CAGR of almost 18% during the forecast period. *GlobeNewswire* [online]. Paris: GlobeNewswire, 2021. Available from: https://www.globenewswire.com/news-release/2021/07/05/2257756/0/en/The-Global-Big-Data-Market-is-expected-to-grow-by-247-30-bn-during-2021-2025-progressing-at-a-CAGR-of-almost-18-during-the-forecast-period.html.

- usually maximizing profit or increasing turnover.

The main benefit of PA is the reduction of transaction costs achieved by work with big data and automatization of business processes. PA also assists in decision-making process for managers. Another benefit lies in the optimization of stock management, which is important for perishable goods.

However, wider application of PA leads to significant negative effects, especially from the perspective of competition law and consumer protection. There is a risk of discriminatory behaviour of algorithms towards different groups of consumers by personalised pricing based on available data of customers (social media behaviour, average income, lifestyle, etc.). [7] Moreover, algorithms tend to behave like a cartel[8] and fix prices. In longer term, market stagnation can be observed, indicated by the decrease of the innovation rate.

### 1.1. Pricing algorithms and competition law

Findings of the experts and judicial precedents reveal that PA have been the subject of increased scrutiny by antitrust authorities around the world for a longer time now.

As a landmark case presenting the distortion of competition by PA can be considered the case US. v. David Topkins (2015), or the so-called "Poster Cartel".[9] The company selling posters on Amazon, headed by David Topkins, has made a deal with other poster sellers to keep prices at the same level and has deployed a special algorithm developed by Topkins himself. The case shows a deliberate deployment of an algorithm with the clear goal of acting in concert.

In 2018, the European Commission noted that price algorithms can lead to vertical price agreement, specifically in resale price fixing. The issue is demonstrated by the case Asus, Denon & Marantz, Philips and Pioneer (CASE AT.40465 - ASUS), where the manufacturers intentionally used a price monitoring algorithm on the price comparison websites to detect deviations of resellers' price and keep it at a certain level.[10]

Thus, PA can facilitate prohibited cartel conduct. However, this is not an

[7] COMPETITION AND MARKET AUTHORITY. Pricing algorithms: Economic working paper on the use of algorithms to facilitate collusion and personalised pricing. London, 8 October 2018, p. 20.

[8] Personal pricing, on the other hand, limits collusion: individual approach to pricing increases the deviations from the price agreed by the cartel participants, what reduces its stability (CMA, 2018).

[9] EZRACHI, Ariel and STUCKE, Maurice E., Artificial Intelligence & Collusion: When Computers Inhibit Competition (April 8, 2015). University of Illinois Law Review, Vol. 2017, 2017, Oxford Legal Studies Research Paper No. 18/2015, University of Tennessee Legal Studies Research Paper No. 267, p. 1777.

[10] ZELENIUK, Anastasia a Antonyna YAHOLNYK. Antitrust Implications of Using Pricing Algorithms. *Chambers and partners* [online]. London, 2021, 13 March 2020. Available from: https:// chambers.com/articles/antitrust-implications-of-using-pricing-algorithms.

autonomous action of algorithms, but the anticompetitive intentions of competitors, to which competition law responds with an explicit prohibition.

Currently, there is a generally accepted categorization of scenarios in which pricing algorithms can facilitate competitors' prohibited actions proposed by Ezrachi et Stucke.[11] These situations are as follows:

**1) Computer as Messenger.** This scenario was described above, where managers of different companies agree to collude and then deploy PA to monitor the market situation and set prices in accordance with the agreement. This is an example of the breach of antitrust legislation.

**2) Hub and Spoke.** This situation may occur if many competitors on the same market use the same or even single PA or entrust their pricing policy to the same software provider who also indirectly collects a large amount of data from software users. This data can then be used to coordinate pricing changes.

The example of such coordination is the case of the Lithuanian company Eturas - the owner of exclusive rights and administrator of the E-TURAS software used by travel agencies to online tour booking. Eturas had notified the users that the maximum discount for online purchases is now limited to 3% in order to "normalize the conditions of competition". In 2014 the Lithuanian Supreme Administrative Court ruled that this move, along with the implicit consent of travel agencies, constituted a prohibited horizontal price agreement caused by vertical input. In 2016, the Court of Justice of the European Union (hereinafter also "CJEU") confirmed that this ruling complies with the EU law.[12]

It is worth to mention the Uber's pricing algorithm, also called an "algorithmic monopoly":[13] It gives the impression that the ride price follows the competitive average, but in reality, it is above the real market price. The problem arises when the number of drivers using the algorithm increases what causes the overall price growth on the taxi market. In this case, there may not necessarily be a breach of competition, but the parallel use of the algorithms by a larger number of competitors may lead to tacit horizontal collusion.

**3) Predictable agent.** The potential negative impact on competition can be caused by the fact that algorithms react to changing market conditions in the same way, thereby reducing the strategic uncertainty of competitors. Deployment of algorithms across the whole sector may lead to the transformation of market dynamics towards a greater price parallelism and higher prices. Moreover, many

[11] EZRACHI, Ariel and STUCKE, Maurice E., Artificial Intelligence & Collusion: When Computers Inhibit Competition (April 8, 2015). University of Illinois Law Review, Vol. 2017, 2017, Oxford Legal Studies Research Paper No. 18/2015, University of Tennessee Legal Studies Research Paper No. 267, p. 1777.

[12] Judgment of the Court (Fifth Chamber) of 21 January 2016, 'Eturas' UAB and Others v Lietuvos Respublikos konkurencijos taryba, Case C-74/14.

[13] EZRACHI, Ariel and STUCKE, Maurice E., Artificial Intelligence & Collusion: When Computers Inhibit Competition (April 8, 2015). University of Illinois Law Review, Vol. 2017, 2017, Oxford Legal Studies Research Paper No. 18/2015, University of Tennessee Legal Studies Research Paper No. 267, p. 1788.

algorithms are trained by reinforcement learning based on the trial-error principle, which can be seen as additional factor leading to the price parallelism - in attempt to gain a financial advantage, algorithms mirror the fluctuation of competitors' prices. While the conscious parallelism is not considered to be anticompetitive, the problem arises when the mirrored price is higher than the price of fair competition.

A group of Italian experts[14] in their paper point out that the risk of algorithmic collusion is quite possible. The authors modelled the behavior of two independent PA in simulated market conditions: the algorithms were developed as Q-learning algorithms and its training was based on reinforcement learning with the goal to achieve the best financial outcome. Memory capacity of the PA was set to remember one previous step of the "competitor". After training, the algorithms simultaneously played repeated games, and after a series of experiments, the authors concluded that even relatively simple algorithms tend to partial collusion (after a temporary deviation, the price achieved by the algorithms returned to the original level, but the fact that the algorithms with second move was following the price was obvious). The algorithms, however, were not set up for identical behavior or any communication. This experiment demonstrates the potential consequences that are likely to arise from the wider deployment of PA. Although, we cannot speak of cartel agreements: once the algorithms are switched off (which does not seem realistic in the modern world), prices should return to the original competitive level.

Within this scenario, it is worth mentioning Amazon's pricing strategy based on dynamic pricing. In 2020, about 250 million price changes across the platform were made, with price changing in average every 10 minutes.[15] Amazon's algorithm is AI-based and given its share on the e-commerce market,[16] has a huge amount of data from platform users - sellers and customers - which serves as the basis for strategic pricing planning. With its technology, Amazon is stimulating the transformation of the retail segment: not only is it having an impact on accelerating the dynamics of price changes, but it is leading to greater automation and the deployment of pricing algorithms, which appears to be a necessity for a successful business today.

In fact, concerns about tacit collusion emerged by collaboration of the same price algorithms require further investigation through experiments in simulated market conditions and real-world tests. It is very likely that once a PA is deployed, a firm will change its default settings according to its own criteria, so

[14] CALVANO, Emilio, Giacomo CALZOLARI, Vincenzo DENICOLÒ a Sergio PASTORELLO. Artificial Intelligence, Algorithmic Pricing, and Collusion. *American Economic Review*. 2020, **110** (10), 3267-3297. ISSN 0002-8282. Available from: doi:10.1257/aer.20190623.

[15] SARICAYIR, Basak. Amazon Pricing Strategy: Lessons to Learn in the Jungle. *Prisync* [online]. Istambul: Prisync, 2021 [cit. 2021-9-10]. Available from: https://prisync.com/blog/amazon-pricing-strategy/.

[16] In 2019, 52,4 % in the US.

symmetry in the sense of two identical algorithms is more of a theoretical issue. At the same time, it should be noted that currently it is not realistic that a reinforcement learning algorithm would be able to change its strategy in favor of cooperation with another one without this ability being designed by the developer. Here we see clear human intervention violating antitrust law. Furthermore, it is important to remember that the cooperation of existing algorithms cannot happen without the "agreement" of the entrepreneurs, or with the inaction of one of them preventing the collusion of PA. For the collusion of this type, competitors should meet at least 3 conditions: [17]

1. to be able to "decode" each other's pricing algorithms,
2. to make a subsequent revision of their pricing strategy to accept the "proposition" of the competitor's algorithm to cooperate by the price raise beneficial for both competitors,
3. not to be able to rapidly adapt their algorithms to collusion and this fact should be commonly known.

Failure to meet the third condition would mean that the firm has the technological capability to identify and decode competitors' algorithms and react in advance to any potential deviation. That makes the collusion less profitable and quite unnecessary.

There are other factors that increase the likelihood of tacit collusion:

- it is a market with a homogeneous or similar product with market segmentation and price fixing,
- market information such as price, quantity of goods and market share of each competitor is transparent, which also prevents cheating within cartel,
- competitors operate in symmetric conditions: they have the same cost structure and respond flexibly to a competitor's price reduction. Otherwise, the lower-cost firm would simply set the price below the market level, [18]
- the algorithm can value future profit. The strategies will be different for short-term and long-term profit. [19]

**4) Digital Eye—Optimizing Performance.** With the development of computer science, it is not surprising that artificial intelligence is also involved in price setting. One of the widely used principles of AI learning is deep learning. Simply put, it is a multi-layered neural network with layers composed of many neurons. The network simulates the operation of the human brain. Each additional

[17] SALCEDO, Bruno. Pricing Algorithms and Tacit Collusion. Pennsylvania, 2015, 11.01.2015, 30, p. 4.

[18] DENG, AI. What Do We Know About Algorithmic Tacit Collusion?: When Computers Inhibit Competition. Antitrust, Vol. 33, No. 1, Fall 2018, p. 92.

[19] COMPETITION AND MARKET AUTHORITY. Pricing algorithms: Economic working paper on the use of algorithms to facilitate collusion and personalised pricing. London, 8 October 2018, p. 5.

layer allows refinement and optimization of the accuracy of predictions or data patterns: algorithm collects the data from the first layer and demonstrates the final solution on the last one.[20]

The use of AI greatly facilitates the process of price setting according to current demand, price fluctuations, historical prices, future demand forecasts, stock levels and other factors that are important for maximizing profit or improving performance. AI can instantly evaluate vast amounts of data in real time and determine a pricing strategy or adapt it to market changes using the obtained information. Currently, there is a number of AI-based solutions available on the market, such as the Czech startup Yieldigo for dynamic pricing[21] or the American software vendors Prisync, Scalr.ai, Omnia AI, Price2spy, Priceedge and others.

The risk for competition arises with the assumption that AI can create a strategy of collusion with a similar algorithm or change the existing strategy in favor of tacit collusion. With advances in AI development, the risk of algorithms' tacit collusion will be more of an issue, especially given that AI operates as a black box. However, a necessary condition for collusion is the ability of AI to judge that such action will yield greater benefits than fair competition.[22]

## 2. CURRENT COMPETITION LAW FRAMEWORK

Competition authorities in Europe and the US recognize that the current legislation is limited in relation to the investigation and detection of tacit collusion of price algorithms. Moreover, tacit collusion is not considered illegal: the authorities traditionally look for evidence of direct or indirect contact, the so-called 'meeting of the minds' of competitors, confirming their concerted action.[23] The European Parliament highlighted the lack of response from the Commission on competition policy in the digital age in the Resolution of 9 June 2021 on Competition Policy - Annual Report 2020.[24]

[20] IBM CLOUD EDUCATION. Deep Learning. *IBM* [online]. Armonk, New York, U.S: IBM, 2021. Available from: https://www.ibm.com/cloud/learn/deep-learning.

[21] BREJČÁK, Peter. Roste tlak na efektivní cenotvorbu, hlásí Yieldigo. Po investici 55 milionů získalo ocenění od Gartnera a dále dobývá Evropu. *CzechCrunch.cz* [online]. Praha: CzechCrunch, 2021. Available from: https://cc.cz/roste-tlak-na-efektivni-cenotvorbu-hlasi-yieldigo-po-investici-55-milionu-ziskalo-oceneni-od-gartnera-a-dale-dobyva-evropu/.

[22] ASKER, John and FERSHTMAN, Chaim and PAKES, Ariel, Artificial Intelligence and Pricing: The Impact of Algorithm Design (March 1, 2021). *CEPR Discussion Paper No. DP15880*, Available at SSRN: https://ssrn.com/abstract=3805295, p. 11.

[23] Algorithms and Collusion - Background Note by the Secretariat, submitted for the OECD Competition Committee Hearings on 21-23 June 2017, DAF/COMP/WD(2017)4, at 17 (16 May 2017).

[24] European Parliament resolution of 9 June 2021 on competition policy – annual report 2020 (2020/2223(INI)). Strasbourg: European Parliament, 2021.

### 2.1. Czech Republic

The issue of competition law at the national level is regulated by Act No. 143/2001 Coll., on the protection of competition (hereinafter also "the Competition Act"), which in Sections 3 to 7 prohibits anticompetitive agreements and any conduct of competitors in concert. The Competition Act reflects the provisions of Article 101 of the Treaty on the Functioning of the European Union (TFEU). In the case of intelligent PA, competition could be distorted without intentional activity of competitors. Thus, the conduct of algorithms might not give rise to the liability of competitors under the definition of offences in Article 22 et seq. of the Competition Act. In the future, it will be important to assess the scope of the entrepreneur's preventive duty, i.e. the requirements to prevent possible negative effects of their conduct. In addition, the development of liability law in the context of the wider application of AI will have an impact on the whole area of competition law.[25]

For consumer protection, the provisions of Section 11(c) of the Competition Act prohibiting price discrimination may be applied. In the context of competition, the question of protection of personal data, in particular the data that customers leave on the Internet, is also relevant. This issue is regulated by Act No. 110/2019 Coll., on the processing of personal data, implementing the regulation of the General Data Protection Regulation (GDPR).

### 2.2. Overview of possible actions of antitrust authorities

In the beginning of this chapter, it is important to note that a blanket ban on PA is not an option in the current environment: it would have even more negative impact on the market. As mentioned above, PA bring benefits to businesses in terms of cost reduction and optimization of business processes and play an important role in the evaluation of big data. Therefore, the measures must be implemented against specific entities in specific situations.

The Commission considers creating a new competition tool to be applied in the form of intervention in cases with a higher risk of distortion or restriction of competition when the competition problems cannot be addressed under the current EU competition law. This tool will allow the Commission to impose behavioral and, where appropriate, structural remedies without imposing fines or damage claims which may on the contrary harm competitors and impede the

[25] KOLEKTIV AUTORŮ Z TECHNOLOGICKÉHO CENTRA AKADEMIE VĚD ČR, ČESKÉHO VYSOKÉHO UČENÍ TECHNICKÉHO V PRAZE A ÚSTAVU STÁTU A PRÁVA AKADEMIE VĚD ČR. *Výzkum potenciálu rozvoje umělé inteligence v České republice: Analýza právně-etických aspektů rozvoje umělé inteligence a jejích aplikací v ČR*. Praha: Úřad vlády ČR, 2018, p. 45.

proper functioning of the market.[26]

It is important to clearly define the indicators of higher risk of distortion of competition. With the development of AI, it can be expected that the mutual identification of algorithms and the creation of mutually beneficial strategies will become easier in future years. For this reason, the authorities are more likely to rely on current market information pointing to cartel behavior: higher concentration of competitors on the market, artificial price growth not caused by external factors or barriers to enter the market. And more generally, stagnation in the industry, a reduction in innovation, etc.

To address the regulation of liability, the Commission proposes a risk-based approach categorizing AI-based technologies: those with unacceptable risk (threatening the safety, livelihood and people's rights) are completely prohibited. For the high-risk technologies, certain obligations will be put on developers and other stakeholders before the technology is placed on the market: these include requirements on the approval process, risk assessment, clear and detailed user manuals, human supervision during the lifecycle, cybersecurity. Furthermore, the regulation defines the conditions of the strict liability of the stakeholders (developers, operators, users - entrepreneurs) for any damage caused by technology.[27] This approach will be regulated by the Artificial intelligence act[28], which will apply to all sectors.

Another option is to define the requirements on the technology itself: considering the tendency of algorithms to collude, PA could be designed to prevent collusion or promote healthy competition. Moreover, real-world algorithms can be tested in simulated market conditions to see if their behavior leads to collusion. The same type of testing could be used to rule out discrimination against consumers.[29]

In the future, the authorities themselves probably could benefit from the development of AI able to identify anticompetitive behavior of PA. However, this solution will depend on the overall technological advancement and opportunity for innovation on the national level.

## CONCLUSION

Nowadays, more and more business entities entrust their pricing policy to pricing algorithms. Their widespread use brings a number of benefits for firms

[26] EUROPEAN COMMISSION. *INCEPTION IMPACT ASSESSMENT* New Competition Tool ('NCT'). Ref. Ares(2020)2877634 - 04/06/2020.

[27] European Parliament resolution of 9 June 2021 on competition policy – annual report 2020 (2020/2223(INI)). Strasbourg: European Parliament, 2021.

[28] Proposal for a Regulation of the European Parliament and of the Council laying down harmonised rules on artificial intelligence (artificial intelligence act) and amending certain union legislative acts 2021/0106(COD). Brussels, 2021.

[29] DENG, Ai. What Do We Know About Algorithmic Tacit Collusion?: When Computers Inhibit Competition. Antitrust, Vol. 33, No. 1, Fall 2018, p. 91.

and industries. Although, there are also growing concerns from antitrust authorities about the potential of pricing algorithms to distort competition. Experiments have proved that people are unable to reach agreements without explicit communication.[30] Pricing algorithms easily overcome this human weakness. Ezrachi and Stucke define 4 scenarios where competition is destabilised. Scenarios 1 and 2 represent clearly prohibited conduct. More complicated are scenarios 3 and 4, which anticipate autonomous behaviour of PA. However, a larger experimental base is needed to unequivocally conclude that all PA act in concert: collusion does not occur in every case, it is often a rational behaviour of a competitor, and conscious price parallelism is not illegal. The preventive duty imposed on developers, operators and entrepreneurs becomes more important, and there is a presumption that the regulation of liability for damage caused by algorithmic tacit collusion will evolve as the regulation of liability for damage caused by AI progresses. Another option is to test algorithms in near-market conditions to avoid collusion and discrimination against consumers.

Another solution can also be sought in technologies: developers can be obliged to consider the tendency of algorithms to collude, or a special technology can be developed to identify distortions of competition. In future years, further progress can be expected in research on this issue as well as the adoption of new measures that would be effective in combating tacit collusion on the technology level and supporting healthy competition.

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[30] CALVANO, Emilio, Giacomo CALZOLARI, Vincenzo DENICOLÒ a Sergio PASTORELLO. Artificial Intelligence, Algorithmic Pricing, and Collusion. *American Economic Review*. 2020, 110(10), 3267-3297. ISSN 0002-8282. Available from: doi:10.1257/aer.20190623, p. 4.

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# SECTION III
# INSOLVENCY LAW

# The legislative approaches to COVID legislation in the area of insolvency

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***Abstract:*** *The COVID-19 has appeared in several waves in Europe. The lawmaker promptly introduced public health measures and reduced economic activities. After that, the rules focused on business law, insolvency law, enforcement law, and other areas of law were adopted. The article focuses on the nature of the rules concerning COVID-19 insolvencylaw and investigates the principles of prolonging these rules as the reaction to the next waves of COVID-19. The article explains and compares different legislative practices concerning prolonging the COVID-19 insolvency rules.*

***Keywords:*** *COVID-19; Insolvency rules; bankruptcy; epidemic.*

## INTRODUCTION

The COVID-19 has appeared in several waves in Europe[1]. The lawmaker promptly introduced public health measures and reduced economic activities. After that, rules were adopted focusing on business law, insolvency law, enforcement law and other areas of law. This article focuses on a different approach of the legislator in the case of prolonging the temporary insolvency rules passed due to COVID-19.

The different approaches to the creation of legal norms might have resulted in a variety of rules to be examined. So this paper is also focused on whether the legislators create universal abstract norms or create casuistry regulation for specific pandemic situations and how the emergency insolvency rules have been prolonged. These specific emergency rules were adopted by governments due to lockdowns in March 2020, resulting in a significant decline in business income.[2]

Therefore, the paper is supposed to hypothesize that emergency insolvency rules were enacted as casuistry regulation and repeatedly prolonged.

Furthermore, the hypothesis raised the question of how the regulatory

[1] The article has been supported by grant No. F2/60/2021 "Recent Changes in Business, Financial and IT law in the Czech Republic in Response to the Covid-19 Pandemic" of the Prague University of Economics and Business.

[2] MADAUS Stephan and Javier ARIAS F. Emergency COVID-19 Legislation in the Area of Insolvency and Restructuring Law. *European Company and Financial Law Review*, De Gruyter, 2021, **17**(3-4), 318-352.

approaches are flexible[3] and whether it is possible to enact some abstract norms for emergency situations. Usually, in unpredictable situations, ad hoc casuistry rule approach is needed.[4] It is important to mention that the pandemic's appearance has increased due to globalization, integration, exploitation of land, and spreading people close to wild species.[5] Therefore it might be a better solution to create abstract norm amendments. On the other hand, Gabiš concluded that there is no clear solution to new legal issues and case to case approach could prevail due to looking for an ideal solution for each particular case.[6]

It is also assumed that if the legislator has already taken into account some extraordinary situation in the past, the amendment would have less impact on the legal certainty of the subject. One of the problems of ad hoc rule might be the harsh effect of retroactive application.[7]

So the paper might explain the similar or different approaches to prolong the emergency insolvency rules due to COVID-19 in the Czech Republic, Austria, and Germany.

The paper involves literature and methodology in section 1, a comparison of rules in section 2, the discussion in section 3, and the conclusion in the last section.

## 1. METHOD AND LITERATURE

The different emergency COVID-19 legislation is investigated by Madaus and Arias.[8] Moravec also describes the different emergency rules.[9]

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[9] MORAVEC, Tomáš. Insolvency Law in Times of Pandemic. In: Škrabka, Jan and Lukáš Vacuška, eds. *Law in Business of Selected Member States of the European Union*. Proceedings of the XII International Scientific Conference. Prague: TROAS, s.r.o. 2020, pp. 342-348. 978-80-88055-10-5.

These papers compare prolongation rules of emergency insolvency rules in the Czech Republic, Austria, and Germany. From a historical point of view, all these states are based on the German civil law family. Therefore for the analysis, a conceptual framework of comparison is used.[10] The paper focuses on specific legislation passed due to COVID-19 and the prolongation of this regulation. Leszczyński recommends the functional method and geographic based method for analysis.[11] On the other hand, the structural approach is not used because all of these countries are German civil law families[12] or continental European families, but there were different legal scholars in the history of each state. Eidenmüller[13] uses the comparative approach based on functional perspective describing and evaluating how the problem is solved.

Moreover, the legislator might create rules for a specific situation such as that related to COVID-19 as a casuistry rule or for a general pandemic or a catastrophic scenario. Therefore, the paper also deals with casuistry and proposes the rules *de lege lata* in case of criticing the casuistry approach.

The aim of the paper is to examine the potentially different approaches to amending legislation due to COVID 19 concerning emergency insolvency rules.

Firstly, the paper describes the emergency insolvency regulation in the mentioned states. Secondly, the paper investigates if the amendments are temporary or permanent and how the legislator reacted to the next waves of the epidemic. Finally, the paper discusses, which approach is more convenient to the pandemic situation and tries to propose some predictable rules for economic subjects.

## 2. EMERGENCY LEGISLATION

Each legislation of above mentioned states governs the debtor's obligation to open insolvency proceedings and the creditor's right to open insolvency proceedings.[14] The insolvency proceeding might be opened in case of financial distress of the debtor. All states regulate both tests for financial distress, and therefore insolvency proceeding might be opened in case of debtor's inability to

[10] ZWEIGERT, K. KOTZ, H. *Introduction to Comparative law*, Oxford: Clarendon Press, 1998, 744. p. 35. 9780198268598.

[11] LESZCZYŃSKI, L. 'The Legal Theory and the Use of Comparative Research', 19 *Comparative Law Review* [online]. 2016, **19**, 18. 0866-9449 [6 October 2021]. Available from: https://doi.org/10.12775/CLR.2015,.002

[12] Van HOECKE, M., 'Methodology of Comparative Legal Research', *Law and Method, [online]. 2015, 35. 2352-7927 [6. October]. Available from:* https://biblio.ugent.be/publication/7145504, p. 12.

[13] EIDENMÜLLER Horst. Comparative Corporate Insolvency Law, *European Corporate Governance Institute (ECGI)* - Law Working Paper [online]. 2016, **319**, 30. [6 October 2021]. Available from: http://dx.doi.org/10.2139/ssrn.2799863.

[14] Art. 97 CZECH REPUBLIC Insolvency Act, Art. 15a GERMAN FEDERAL REPUBLIC Insolvency Act, Art. 67 and 69 AUSTRIAN REPUBLIC Insolvency Act.

pay debts or debtor's overindebtedness and all examined legislation involved time period for the debtor to fulfill the obligation to open insolvency proceeding opposite to creditor's right to apply for opening insolvency proceeding in case of debtor's financial distress. This debtor's obligation to open insolvency proceedings is set only for companies and sole entrepreneurship.

There are different time periods for the fulfillment of debtor's obligation to file an insolvency petition. In the Czech Insolvency Act[15] this period is set without delay after the occurrence of bankruptcy, in the German Insolvency Act[16] it is set for three weeks and in the Austrian Insolvency Act[17] it set for 60 days in a common situation and for 120 days in an extraordinary situation, for example in case of a natural disaster, epidemic or a similar occasion.[18]

### 2.1. Emergency legislation in the Czech Republic

The debtor has an obligation to file a bankruptcy petition in case of payment default or in case of overindebtedness.[19] In the wording of lex COVID,[20] the suspension of obligation has been set for six months after the ending of extraordinary measures or no later than by 31 December 2021. This suspension is not applied to insolvent debtors before 12 March 2020, or in case the debtor's default does not have a causal link to the extraordinary pandemic measures. The aim of this rule is to suspend the obligation of the statutory body to file an insolvency petition against a corporation in a situation that reduced operational business due to the crisis and extraordinary measures. On the other hand, the statutory body has to follow the best practices and take all reasonable steps to prevent corporation default.

The Czech Act on measurement mitigating SARS-CoV-2 epidemic was

[15] Art. 98 CZECH REPUBLIC No. 182/2006 Coll., on bankruptcy and its solution (Insolvency Act) as amended]. [zákon č. 182/2006 Sb., o úpadku a způsobech jeho řešení (insolvenční zákon), v platném znění]. in text referred as Czech Insolvency Act.

[16] § 15a GERMAN FEDERAL REPUBLIC Insolvency Act from 5 October 1994 as amended. [Insolvenzordnung vom 05. Oktober 1994 (BGBl. I S. 2866) geändert] in text referred as German Insolvency Act.

[17] § 67 AUSTRIAN REPUBLIC Act on insolvency proceeding (Insolvency Act). [Bundesgesetz über das Insolvenzverfahren (Insolvenzordnung) StF: RGBl. Nr. 337/] in text referred as AUSTRIAN REPUBLIC Insolvency Act.

[18] Before amendment § 67 AUSTRIAN REPUBLIC Insolvency Act concerned only natural disaster and similar cases.

[19] Art. 3 CZECH REPUBLIC Insolvency Act.

[20] Art. 12 CZECH REPUBLIC Act No. 191/2020 on measurement mitigating SARS-CoV-2 epidemic. [Zákon č. 191/2020 Sb., o opatřeních zmírňujících epidemii SARS-CoV-2]. in text referred as lex COVID.

amended once by amendment Act No. 460/2020 Coll.[21] This Amendment postponed the period from 31 December 2021 to 30 June 2021 until the obligation of the debtor to file a bankruptcy petition is suspended.

The right to file a creditor's petition is disregarded in the period from 24 April until 31 August 2020. In practice, the insolvency court only informs the filing creditor that the insolvency proceeding is unable to commence.[22] Creditors might file insolvency petitions after 31 August 2020. This rule has not been prolonged yet.

### 2.2. Emergency legislation in Germany

The debtor's obligation to file an insolvency petition within three weeks after occurring default has been suspended until 30 September 2020[23]. The suspension might be prolonged by the Federal Ministry of Justice and Consumer protection until 31 March 2021[24]. This suspension of the debtor's obligation is applicable only in the situation when bankruptcy is a consequence of spreading the SARS-CoV-2 Virus and there is the cumulative condition of an assumption to overcome the bankruptcy of debtors. The German COVID-19 Insolvency Act also sets an assumption that bankruptcy is the consequence of the COVID-19 pandemic. The German COVID-19 Insolvency Act creates the assumption to overcome the bankruptcy under the condition The German COVID-19 Insolvency Act creates the assumption to overcome the bankruptcy under the condition that the situation of the debtor´s inability to pay their debt did not occur before 31st December 2019.

The German COVID-19 Insolvency Act was amended with effect from 1 October 2020.[25] The debtor´s obligation to file the bankruptcy petition was suspended in the period from 1 October 2020 to 31 December 2020.

The next changes of the German COVID-19 Insolvency Act were indirect by means of the German Restructuring and Insolvency Supporting Act[26] taking effect on 1 January 2021. This Act canceled the right of the Ministry of Justice

[21] CZECH REPUBLIC Act No. 460/2020 on amending the Czech Act No. 191/2020 on measurement mitigating SARS-CoV-2 epidemic. [Zákon č. 460/2020 Sb., kterým se mění zákon č. 191/2020 Sb., o opatřeních zmírňujících epidemii SARS-CoV-2].

[22] Art. 13 ibid.

[23] § 1 GERMAN FEDERAL REPUBLIC Act to Mitigate the Consequences of the COVID-19 Pandemic under Civil, Insolvency and Criminal Procedure Law (COVID-19 Insolvency Act). [esetz zur Abmilderung der Folgen der COVID-19-Pandemie im Zivil-, Insolvenz- und Strafverfahrensrecht (COVID-19 Insolvenzgesetz) vom 27 Marz 2020].

[24] § 4 ibid.

[25] GERMAN FEDERAL REPUBLIC Act amended COVID-19 Insolvency Act. [Gesetz zur Änderung des COVID-19-Insolvenzaussetzungsgesetzes vom 25. September 2020].

[26] Art. 10 GERMAN FEDERAL REPUBLIC Restructuring and Insolvency Supporting Act. [Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts (Sanierungs- und Insolvenzrechtsfortentwicklungsgesetz – SanInsFoG) vom 22. Dezember 2020].

and Consumer protection to extend the statutory protection and suspend the obligation to file a bankruptcy petition for debtors applying for German state aid in January 2021 or the debtors, who are eligible applicants for state aid. The article was subject to Amendment[27] and the period was prolonged until 30 April 2021.

In German law, there has remained the creditor's right to file an insolvency petition between 28 March and 28 June 2020 only under the condition that the reason to open the insolvency proceeding already existed prior to 1st March 2020.

### 2.3. Emergency legislation in Austria

There were two essential amendments in Austrian insolvency law. The first amendment[28] also included epidemic and pandemic into the rules setting the period of 120 days for the commencement of insolvency proceeding besides natural disaster. In the Austrian Insolvency Act, there is a particular rule prolonged time of obligation to file a petition in case of an earthquake, flood, or another natural disaster.[29] Under this amendment, this period of 120 days is also applicable in case of epidemic or pandemic. The second amendment[30] suspended the debtor's obligation to open insolvency proceedings and creditors right in case of debtor's overindebtedness.

The debtor's obligation to file an insolvency petition within 120 days is suspended in case the debtor's overindebtedness occurs in the period from 1 March to 31 June 2020. After the expiry of this period, the debtor has an obligation to file the petition within 60 days from 31 June or within 120 days after the overindebtedness occurs, which happens later.[31]

The obligation of the debtor to file a petition in case of inability to pay debts remains unaffected in the Austrian insolvency law.

The right to file the creditor's petition remains unaffected in case of the debtor's inability to pay debts. The right to file the creditor's petition based only on the debtor's overindebtedness has been restrained in the period from 1 March to 30 June 2020.[32]

The Austrian legislator amended the fourth COVID Act five times.

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[27] GERMAN FEDERAL REPUBLIC Act extending the suspension of the obligation to file for bankruptcy. [Gesetz zur Verlängerung der Aussetzung der Insolvenzantragspflicht und des Anfechtungsschutzes für pandemiebedingte Stundungen sowie zur Verlängerung der Steuererklärungsfrist in beratenen Fällen und der zinsfreien Karenzzeit für den Veranlagungszeitraum 2019 vom 15 Februar 2021].

[28] Artikel 22 AUSTRIAN REPUBLIC Act 2. COVID Act. [Gesetz BGBl. I Nr. 16/2020 (2. COVID Gesetz)].

[29] § 69 AUSTRIAN REPUBLIC Insolvency Act.

[30] Art. 9 4. AUSTRIAN REPUBLIC Act. 4. COVID. [Gesetz BGBl. I Nr. 24/2020 4.COVID Gesetz].

[31] § 9 ibid.

[32] § 9 AUSTRIAN REPUBLIC Fourth COVID Act.

Firstly, the suspension was extended from 30 June 2020 to 31 October 2020.[33] The second extension postponed the period from 31 October 2020 to 31 January 2021.[34] The third extension was approved until 31 March 2021.[35] The fourth extension prolonged the period until 30 June 2021[36] and the last extension was approved until 31 December 2021.[37]

## 3. COMPARISON OF EMERGENCY INSOLVENCY RULES

There are different approaches to how the legislator reacts to specific pandemic situations and how to amend the rules. The first part of this chapter focuses on different rules of emergency legislation and the second part on the way, how the rules were changed.

### 3.1. Comparison of Emergency legislation rules

Firstly, the part is focused on the case of the inability to pay debts. The Austrian legislator has adopted no amendments except for the clarification that a longer period for fulfilling the debtor's obligation to file the insolvency petition is also applicable to epidemics and pandemics besides natural disasters. Similarities might have been seen in Czech and German legislation but there are some differences. The Czech legislator was inspired by German rules, but a very casuistry solution has been chosen and set a fixed period for suspension of fulfilling the obligation to file a bankruptcy petition. The German legislator also set the fixed period for suspension of debtor's obligation but also granted discretional power to the Ministry of Justice and Consumer Protection to extend this period until 31 March 2021.

There are also differences in the condition under which suspension of debtor's obligation is enacted. Both the German and the Czech legislation set the condition that default of debtor has got causal links to the COVID-19 pandemic. Furthermore, the German legislator set the condition that there was an assumption

[33] AUSTRIAN REPUBLIC Act on amendment COVID Acts. [Änderung des COVID Gesetzes. BGBl 58/2020].

[34] AUSTRIAN REPUBLIC Act on amendment COVID Act. [Änderung des COVID Gesetz. BGBl 113/2020].

[35] AUSTRIAN REPUBLIC Act on amendment Notary Act. [Gmbh Act and COVID Act. Änderung der Notariatsordnung, des GmbH-Gesetzes und COVID Gesetz. BGBl 157/2020].

[36] AUSTRIAN REPUBLIC Act on amendment Health and Nursing Act, the MTD Act, the Federal Care Allowance Act, the Motor Vehicle Act 1967, the Driving License Act and COVID Act. [Änderung des Gesundheits- und Krankenpflegegesetzes, des MTD-Gesetzes, des Bundespflegegeldgesetzes, des Kraftfahrgesetzes 1967, des Führerscheingesetzes und COVID Gesetz. BGBl 48/ 2021].

[37] AUSTRIAN REPUBLIC Act on amendment the Disciplinary Act for attorney and attorney trainee and Attorney Act and COVID Act. Änderung des Diziplinarstatuts für Rechtsanwälte und Rechtsanwaltsanwärter, der Rechtsanwaltsordnung, des 1. COVID-19-Justiz-Begleitgesetzes und COVID Gesetz. BGBl 106/2021].

of possibility to overcome the default. On the other hand, the Czech and German legislators set different dates for the occurrence of bankruptcy. In the Czech legislation, suspension of the debtor's obligation is applicable only on the condition that default occurs after 12 March 2020, but German legislator set a presumption that there was no inability to pay debts on 31 December 2019.

Secondly, this part deals with the case of an obligation to file an insolvency petition in the case of overindebtedness. All legislators set the suspension period for this obligation of the debtor to file an insolvency petition. The Austrian legislator has not set any condition for the application of this suspension and set the fixed period from 1 March to 30 June 2020.

The Czech and German legislators set the same conditions and periods mentioned above in the case of the inability to pay debts.

In the case of the debtor's obligation to file the insolvency petition, there are different periods of time for fulfilling the debtor's obligation. The Czech and the German legislators have not amended the period of fulfillment of obligation after the expiry of the suspension period. The Austrian legislator amended the period so that the debtor has to fulfill the obligation to commence insolvency proceeding within 60 days after expiry of suspension period or within 120 days in the situation that overindebtedness of debtor has occurred after 1 September 2020.

The amendments to commencement of insolvency proceeding affecting the creditor's right to file an insolvency petition were created similarly as in the suspension of debtor's obligation to file an insolvency petition. The Austrian legislator has not amended the legislation in case of inability to pay debts. The Czech legislator has restricted the right of creditors to file insolvency petitions for all cases in the period from 24 March to 31 August 2020. The German legislator has also restricted the creditors' rights in a fixed period from 28 March to 28 June 2020 but only under the condition that the debtor's default occurs after 1 March 2020. The Czech legislation has also set a fixed period as in previous cases unlike the German legislation that has granted discretional power to the Ministry of Justice and Consumer Protection to extend this period until 31 March 2021.

In the last case, the approaches of legislators to the creditor's right to file an insolvency petition in case of debtor's overindebtedness are showed. The Czech and German legislators have chosen the same way in the case of the debtor's overindebtedness as in the above mentioned case of the debtor's inability to pay debts. The Czech legislator has set a fixed restriction of rights without the possibility to overturn this restriction. Therefore, all debtors are protected in the preceding period without any connection to the pandemic. In German jurisdiction, the restriction of creditors to file an insolvency petition in the fixed period from 28 March to 28 June 2020 might be overturned by proving default of the debtor before 1 March 2020. To be complete, it should be kept in mind that a fixed period in German law might be extended by the Ministry of Justice and Consumer Protection. The Austrian legislator has restricted the creditor's right to

file an insolvency petition in case of the debtor's overindebtedness in the period from 1 March to 31 October 2020 under the condition that the debtor's inability to pay debts has not occurred. The approach is similar to the suspension of the debtor's obligation in case of overindebtedness.

### 3.2. Comparison of prolongation of emergency rules

The legislator chose a different way to prolong the period. The Austrian legislator changed the final period of suspension of the obligation to file bankruptcy five times and usually postponed the period for three months. The last postponing was for half a year. The suspension period involved the debtor's obligation or the right of creditors to file a bankruptcy petition in case of debtor overindebtedness.

The German legislator enacted the suspension of the obligation to file a bankruptcy petition in the case of both forms of default and suspended creditors' right to file a bankruptcy petition with the possibility to prove that default has occurred before 1 March 2020. The Ministry of Justice and Consumer Protection could prolong the suspension period, and this rule was canceled as of 1 January 2021.[38] On the one hand, the regulation by the Ministry order was flexible; on the other hand, there could be uncertainty whether the period would be prolonged. The German legislator amended legislation and suspended the obligation to file a bankruptcy petition from 30 October 2020 to 31 December 2021 in case of overindebtedness. The next change of rules was initiated by the German Restructuring and Insolvency Supporting Act. This Amendment suspends the obligation to file bankruptcy in the case of the possibility of qualifying for a state aid. Second, there were changes amending the condition for the testing period of indebtedness due to COVID-19 with the following condition: the debtor was not in default on 31 December 2019, the debtor had positive income on previous financial year and the turnover decreased at least by 30 percent compared to the previous year.

The Czech legislator postponed the suspension period for the debtor obligation to file the bankruptcy petition for half a year.[39]

## 4. DISCUSSION

The legislation of each of the mentioned states implemented the recommended measures to mitigate the consequences of the COVID-19 pandemic and economic decline. The measure was recommended by business and insolvency

[38] Art. 10 GERMAN Restructuring and Insolvency Supporting Act. [Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts (Sanierungs- und Insolvenzrechtsfortentwicklungsgesetz – SanInsFoG) Vom 22. Dezember 2020].

[39] CZECH REPUBLIC Act No. 460/2020 on amending the Czech Act No. 191/2020 on measurement mitigating SARS-CoV-2 epidemic. [Zákon č. 460/2020 Sb., kterým se mění zákon č. 191/2020 Sb., o opatřeních zmírňujících epidemii SARS-CoV-2].

law theorists.[40] After examining amendment rules concerning the commencement of insolvency proceedings under the pressure of economic circumstances of the COVID-19 pandemic, it could be confirmed that all the examined states had amended regulations under the pressure of the COVID-19 pandemic. In the examined legislation, different approaches have been chosen, varing from the very casuistry to the general one. It has also been seen that the most general regulation, that has already taken into account some extraordinary situation, for example, a natural disaster, has been amended less.

These rules for suspension of obligation of debtors and for some restrain of creditors' rights are needed in this crisis situation. On the other hand, these rules should be created in respect of repeating crises or extraordinary situations. From this aspect, it is proposed to create an abstract rule with a longer period for the debtor's obligation to open insolvency proceedings *de lege lata*. On the one hand, inspiration can be drawn from the Austrian Insolvency Act specifying postponing the obligation of the debtor in case of natural disaster, epidemics or a similar extraordinary situation and on the other hand, the Austrian legislator was very prudent about the suspension of an obligation to file bankruptcy petition by the debtor. Also, the creation of an automatic restrain of creditor's right to file an insolvency petition for the period of three months, by statutory provision in case of extraordinary measures can be suggested. The condition should be respected that default of debtor should have a causal link to extraordinary measures. On the other hand, the legislation should ensure that secondary inability to pay debts will not occur.

The German legislator amended rules differently and created additional new rules. What can be inspiring is the rules that define the condition for the testing period for the indebtedness suspension period. The thread of potential new diseases could be defined as general rules for an epidemic or catastrophic situation.

The general rules might increase the predictability and the debtor might be prepared for this situation, as opposed to ad hoc rules. In the case of ad hoc rules, it is very difficult to predict the new norm or amendment and in the business environment, this unpredictability might lead to an earlier exit from the market.

## CONCLUSION

As the pandemic was a specific situation in the last one hundred years, this led to the creation of ad hoc rules. Due to information lack, the rules were prolonged differently. So, the hypothesis was confirmed.

[40] ENRIQUE, L. Pandemic-Resistant Corporate Law: How to Help Companies Cope with Existential Threats and Extreme Uncertainty During the Covid-19 Crisis Law Working Paper N° 530/2020 July 2020 or MADAUS S, ARIAS F.J. Emergency COVID-19 Legislaton in the Area of Insolvency and Restructuring Law. *European Company and Financial Law Review*, De Gruyter, 2021. 17(3-4), pp. 318-352.

There was also uncertainty whether a competent authority would prolong the rules. *De lege lata*, it is proposed to prepare insolvency rules for emergencies and ad hoc rules under set conditions which can e transfered to general rules due to the possibility of another emergency situation.

The condition for triggering the specific rules could be defined as the state of emergency or a specific government order. So, some flexibility might be ensured in triggering the rules in an unpredictable situation. These specific norms could be applicable to a specific situation or on the affected territory. The affected territory could be defined as an administrative district.

The limitation of the creation of general rules could be impossible to predict in all situations or possible solutions for each particular case.

After the pandemic, the impact of emergency rules on the market and the insolvency cases could be investigated. The impact and efficiency of emergency rules might be also subject of next researches.

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# Remuneration of insolvency practitioners in reorganization proceedings as a possible inspiration for preventive restructuring?

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***Abstract:*** *The draft law on preventive restructuring transposing Directive (EU) 2019/1023 envisages creating the profession of restructuring practitioner. The aim of the article is to offer recommendations for the forthcoming legislation, which is to regulate the calculation of remuneration for this new profession. The article deals with the procedural position and tasks of the restructuring practitioner in preventive restructuring and compares them with the activities of the insolvency practitioner within the reorganization. Based on the similarities and differences, the article examines whether the existing model of remuneration of insolvency practitioner in the reorganization (monthly fee) can be considered a suitable inspiration for the planned decree on the remuneration of the restructuring practitioner. The recommendations de lege ferenda are also based on the analysis of alternative remuneration models (including the German transposition norm).*

***Keywords:*** *insolvency practitioner, restructuring administrator, remuneration, preventive restructuring, reorganization.*

## INTRODUCTION

The corporate insolvency law in the Czech Republic has undergone a dynamic development in recent years.[1] A novelty is the Draft Act on Preventive Restructuring (hereinafter also "DAPR") of July 2021, which is to transpose Directive (EU) 2019/1023 on restructuring and insolvency.[2]

[1] The article was created within the Prague University of Economics and Business Internal Grant Agency Project No. F2/74/2021. The presented opinions do not represent the official position of the institution in which the authors work.

[2] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures

Although insolvency proceedings and preventive restructuring are collective procedures with a similar purpose, which is (in general) the solution of the negative economic situation of debtors, these are diametrically different concepts. They differ from each other in the basic principles of legal regulation, the choice of procedural framework, the conditions for initiation and the roles of individual procedural subjects.[3]

Both institutes have an involvement of neutral procedural subjects in common, which contribute to the fulfilment of the purpose and successful course of the given proceedings and compensate for the centrifugal tendencies resulting from the different individual interests of different participants.[4] To some extent, this function is held by the courts. However, the administration of corporate proceedings requires considerable personnel and material capacity, which allows real-time supervision of the economic situation of enterprises. Therefore, special professions have been created to perform such activities - insolvency practitioner for insolvency proceedings and restructuring practitioner for preventive restructuring.

There are already specific rules for the remuneration of the insolvency practitioner - their basic regulation is contained in the Czech Insolvency Act (InsA)[5], which is detailed in Decree No. 313/2007 Coll.[6] (hereinafter also "IPRD"). The DAPR leaves the remuneration model of the restructuring practitioner to an implementing regulation, which, however, has not yet been published [§ 135(c) DAPR].

The aim of this text is to offer recommendations *de lege ferenda* for forthcoming legislation on the remuneration approach for the new profession of restructuring practitioner. The text analyses the procedural position and tasks of both restructuring practitioner within preventive restructuring and insolvency practitioner within formal reorganization. Based on the similarities and differences, the text examines whether the existing model of remuneration of insolvency practitioner in the reorganization (monthly fee) can be considered a suitable inspiration for the planned decree on the remuneration of the restructuring practitioner.

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to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

[3] The authors dealt with the characteristics of the institute of preventive restructuring and its differences from insolvency proceedings (and reorganization) in more detail in their previous texts; see e.g. VÍTKOVÁ, K. – ZEZULKA, O.: New Institute of Preventive Restructuring and Inspiration by Foreign Legislation. In: *Právo v podnikání vybraných členských států Evropské Unie – sborník příspěvků k XI. ročníku mezinárodní vědecké konference*. 1st ed. Praha: TROAS, s.r.o., 2019, pp. 269-276.

[4] ZEZULKA, O.: O postavení insolvenčního správce. *Právní rozhledy*, No. 21/2019, p. 748.

[5] Act No. 182/2006 Coll., on Bankruptcy and its Resolution Methods (Insolvency Act).

[6] Decree No. 313/2007 Coll., on Remuneration of the Insolvency Practitioner, on the Reimbursement of their Cash Expenditures, on Remuneration of Members and Alternates of the Creditors´ Committee and in the Reimbursement of their Necessary Expenses.

Having regard to the above, for the analysis, a functional method of comparison has been used.[7] In accordance with Eidenmüller[8], the authors had chosen such an approach for its suitability for micro-comparison. In other words, this perspective could be used for an in-depth description and evaluations how a particular issue is resolved in different systems.

## 1. THE POSITION AND TASKS OF THE INSOLVENCY AND RESTRUCTURING PRACTITIONER

In order to evaluate whether the existing model of remuneration of the insolvency practitioner in reorganization (monthly flat rate) can be considered a suitable inspiration for the forthcoming decree on remuneration of the restructuring practitioner in preventive restructuring, the authors first proceed to compare the procedural position, tasks and activities of both professions.

### 1.1. Insolvency practitioner

#### 1.1.1. The position of insolvency practitioner

The position of insolvency practitioner has hybrid characteristics. The most widespread and generally accepted theory by the professional public states that the insolvency practitioner is a specific procedural entity combining elements of a public body and a business entity.[9]

Although contemporary theory does not consider the insolvency practitioner to be a representative of creditors (the creditors' representative bodies serve this purpose), regardless of the method of resolving the insolvency, they are obliged to make every effort to satisfy them to the maximum and their common interest [§ 36(1) InsA]. Another general duty of the insolvency practitioner is to proceed conscientiously and with professional care when performing their function [§ 36(1) InsA]. The publicity attribute, on the other hand, is supported by the fact that the insolvency practitioner is procedurally subordinate to the insolvency court, which appoints them to office and decides on their remuneration [§ 25 and § 38 InsA]. The court is also entitled to give them binding instructions, request reports from them, ask them for an explanation of their procedure, inspect their accounts and order the necessary investigations [§ 11(2) InsA]. Attributes of a private nature result mainly from the way in which the profession is organized as a liberal profession, the absence of decision-making power or the nature of the tasks entrusted.

[7] VAN HOECKE, M.: Methodology of Comparative Legal Research. *Law and Method*, pp. 9-11.
[8] EIDENMÜLLER, H.: Comparative Corporate Insolvency Law. European Corporate Governance Institute (ECGI) - Law Working Paper No. 319/2016, p. 3.
[9] *Ditto 4*, p. 757.

### 1.1.2. The tasks of insolvency practitioner

The specific tasks of an insolvency practitioner in a reorganization often emanate directly from the law, depend on the procedural phase of the proceedings and do not vary much in different proceedings. In the reorganization, the practitioner´s importance is manifested more in the initial stages of insolvency proceedings, where they verify critical information on creditors' claims and supervises the activities of the debtor with disposition rights.

After permitting the reorganization, the insolvency practitioner particularly ascertains the extent of the debtor's assets [§ 217 et seq. InsA], compiles and supplements the list of creditors, reviews receivables reported to creditors, conducts incidental disputes and reports to the creditors' committee [§ 331 et seq. InsA]. After the approval of the reorganization plan, the insolvency practitioner is more or less limited to the performance of continuous supervision over the debtor and the performance of various procedural acts envisaged by the reorganization plan [§ 354 et seq. InsA]. The remediation nature of the reorganization preserves the disposition rights for debtors. This, with a few exceptions, does not allow the insolvency practitioner to manage or even monetize the assets (unlike in bankruptcy).

## 1.2. Restructuring practitioner

### 1.2.1. The position of restructuring practitioner

Compared to the insolvency practitioner, the profession of restructuring practitioner shows strengthened elements of a public law nature. The profession of restructuring practitioner may be exercised by all persons who have a special permit to perform the activity of an insolvency practitioner [§ 134(2) DAPR]. At the organizational level, therefore, it is based on a narrower circle of elite insolvency practitioners who are called to administer the most complex cases of corporate bankruptcies.

Other elements are also shared by both professions. The restructuring practitioner is also appointed by the restructuring court, which also decides upon their remuneration. The standard of performance of the function is also identical (the obligation to proceed conscientiously with professional care).

The fundamental difference is the fact that the restructuring practitioner does not pursue the interests of specific persons (i.e. neither the debtor nor the creditors) during the performance of their function, but acts strictly impartially and independently [§ 57(1) DAPR]. The restructuring practitioner is subordinated only to the restructuring court, which supervises them [§ 57(2) DAPR].

In selected procedural scenarios, where the restructuring practitioner per-

forms a completely detached agenda, in which there is even a certain quasi-decision-making, the restructuring practitioner actually acts in a position corresponding to the judicial commissariat (especially the preliminary review of disputed receivables under § 96 et seq. DAPR).

### 1.2.2. The tasks of restructuring practitioner

The agenda of the restructuring practitioner is more diverse and may differ significantly in different cases, as it is less prescribed by law and relies on the imposition of *ad hoc* tasks by the restructuring court as defined by an indicative list in § 57(3) DAPR. In the vast majority of cases, the restructuring practitioner performs one-off tasks of a procedural nature, which prevailingly consist in obtaining a document (expert opinion), conducting a certain investigation and submitting a report on their results, or providing formal statements for the purposes of the preliminary examination.

The restructuring practitioner cannot be authorized with the assets management, nor can they be authorized to monetize the enterprise´s assets by a partial or complete transfer to them [§ 8 in conjunction with § 77(2) DAPR]. In general, the restructuring practitioner can only be entrusted with the control of the enterprise's activities to the extent defined by the decision of the restructuring court [§ 57(a) DAPR]. At most, the restructuring practitioner can be authorized to con-validate the offsetting of the enterprise's receivables or to con-validate the handling of certain assets or rights [§ 76(1) DAPR].

### 1.3. Comparison of both professions

Both institutes equally represent special procedural subjects, which combine elements of a public body and a business entity. However, the position of restructuring practitioner is more diverted towards the concept of public law (sometimes bordering on the judicial commissariat) and enjoys independence and impartiality on the part of the parties.

Diametrically different procedural constructions result in a different character of the appointment of these subjects into function, their procedural position and entrusted tasks. The insolvency practitioner performs their function and tasks imposed by law continuously for the entire period from the determination of bankruptcy until the final termination of the insolvency proceedings.

On the other hand, the restructuring practitioner operates more *ad hoc* in resolving disputes that arise in the hybrid process of preventive restructuring and which only require partial intervention by the restructuring court. DAPR does not impose any long-term tasks on the restructuring practitioner requiring unspecified supervision and continuous informing of the court and the participants in the proceedings [*a contrario* § 354(2) InsA]. The restructuring practitioner provides *ad*

*hoc* co-operation to the restructuring court unless they are exceptionally empowered with the continuous control of the enterprise's activities to a specifically defined extent or with the con-validation authority to enterprise's legal actions. And unlike an insolvency practitioner, the restructuring practitioner cannot under any circumstances be considered the administrator of assets.

## 2. REMUNERATION OF THE INSOLVENCY PRACTITIONER IN REORGANIZATION

In determining the remuneration of an insolvency practitioner in a reorganization, IPRD combines two remuneration models – flat rate and task fee.

The basis is a flat rate model (§ 2 IPRD), where the insolvency practitioner is entitled to a fixed monthly remuneration. The corresponding amount depends on the average annual turnover of the debtor and increases progressively with increasing turnover. In the first flat rate zone for a debtor with an average monthly turnover of up to CZK 100 million, there is a monthly remuneration of CZK 33,000 (excluding VAT), in the last (sixth) flat rate zone for turnover exceeding CZK 1 billion it is already CZK 415,000 (excluding VAT).

The flat rate remuneration is due for each month started after the decision to approve the reorganization, regardless of the complexity or scope of the activities performed. However, InsA allows the insolvency court to reflect both, an increased or a reduced complexity or volume of tasks performed. After consultation with the creditors' committee, the court may reasonably increase or decrease the remuneration of the insolvency practitioner [§ 38(3) InsA].

In addition to the above, IPRD also works with a task fee (§ 2a IPRD) for the review of receivables applications. The insolvency practitioner is entitled to a fee of CZK 1,000 (excluding VAT) for each reviewed application for a claim[10]; a total of a maximum of CZK 1 million (excluding VAT). Here, too, the Decree does not address the differences in the factual complexity of the examination of individual applications which may be extreme due to differences in the contractual documentation and the overall complexity of the legal relationship between the debtor and the creditor.

### 2.1. Statistical analysis of remuneration in successfully finished reorganizations

The mere description of the method of determining the remuneration of the insolvency practitioner in the reorganization cannot be considered by the authors to be sufficient to assess whether this model can be approved as a suitable

[10] In case law, however, it is not (still) completely unified whether the basis for remuneration is the number of applications examined or, in fact, the number of creditors (for details see JIRMÁSEK, T.: Odměna insolvenčního správce z počtu věřitelů nebo přezkoumaných přihlášek? K jednotě soudního rozhodování. *Insolvenční zóna*, 2020. [online].

inspiration for the remuneration of restructuring practitioners. The authors therefore performed a unique statistical analysis.

The authors searched the insolvency register for the occurrence of the events "Bankruptcy decision associated with the reorganization permit" and "Decision on the reorganization permit" for the period from 1 January 2008 to 27 September 2021. In total, the authors found 189 occurrences, which according to Justice represents 80.1% of all cases (one-fifth of the total number of 236 events has already been removed from the public part of the insolvency register).[11] As the remuneration of the insolvency practitioner is decided at the very end of the proceedings, the authors had to rely only on successfully completed reorganisations in which the insolvency court acknowledged the fulfilment of the reorganization plan. There were only 53 of those in the 189 proceedings (i.e. 28%). In one case[12], the insolvency court has not yet decided on the remuneration, despite the formal termination of the proceedings, so it was dropped down. As a result, the authors have worked with a sample of 52 proceedings.

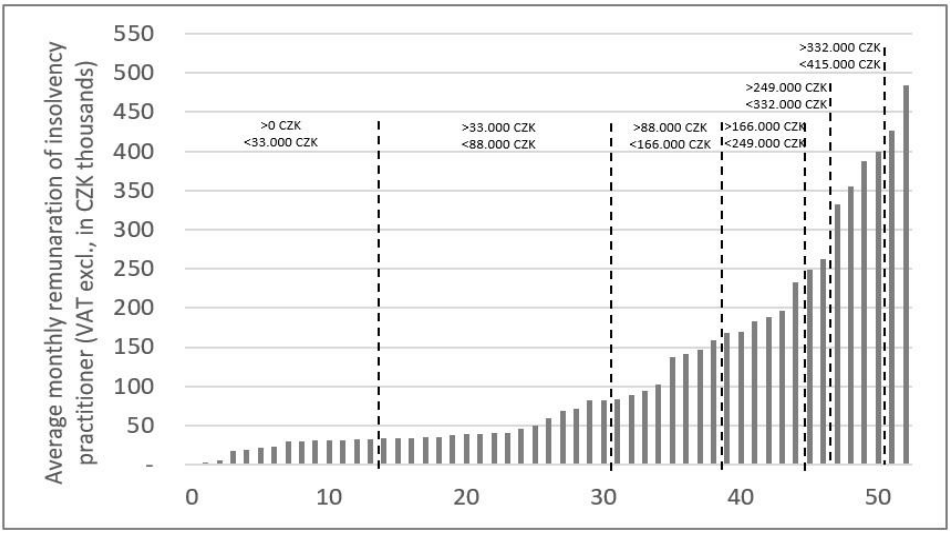
Within the sample, insolvency practitioners were awarded remuneration in the aggregate amount of CZK 161.88 million which averages CZK 3.11 million in each successfully completed reorganization (median CZK 1.89 million). The average duration of the reorganization, which, with regard to the IPRD provisions, is calculated by the authors as the number of months started from the approval of the reorganization to the acknowledgment of the fulfilment of the reorganization plan, was 31 months. The average monthly flat rate fee was 123.93 thousand CZK.

In two thirds of the examined cases, the awarded remuneration does not even reach the average which can also be derived from a comparison with the median value (CZK 59.50 thousand). Paradoxically, there are several cases where the insolvency practitioner received a lower than the minimum remuneration set by the IPRD.[13] In addition, it can be deduced from the median that the most typical category of debtors undergoing reorganization are presumably business corporations with an annual turnover of approximately CZK 200–300 million.

The amount of the insolvency practitioner's remuneration affects (either positively or negatively) the satisfaction of creditors. The authors therefore further examined the effectiveness and efficiency of the insolvency practitioner's involvement in satisfying the debtor's unsecured creditors. Authors focused on unsecured creditors intentionally as the burden of costs lies upon them even despite, they tend to be poorly engaged in the process of insolvency proceedings

[11] Under § 425 InsA, data on the debtor are available in the insolvency register for 5 years after the successful termination of the proceedings.
[12] Proceedings ref. no. MSPH 90 INS 6309/2019.
[13] Cases where the insolvency practitioner agreed with a lower remuneration (for various reasons).

and cannot effectively control the costs of the insolvency practitioner (unlike secured creditors).[14] In these scenarios, the effectivity of the remuneration system is dependent on mandatory legal rules.




*Graph I. Average monthly remuneration granted to insolvency practitioners in 51 successfully finished reorganizations which were terminated between 12/2016 and 09/2021. The vertical boundaries correspond to the remuneration segments according to § 2 IPRD. The amendment of § 2 IPRD effective from 1st January 2014 split former remuneration span of CZK 0-88.000 into two sections. As a result, 3 cases resolved between 2008 and 2013 which would fit into interval of 0-33.000 CZK were classified into 33.000-88.000 CZK span. Source: Czech Insolvency Register.*

On a reduced sample of 48 cases[15], the authors calculated the total amount of funds intended to satisfy unsecured creditors and compared it with the costs of insolvency proceedings consisting in the insolvency practitioner's claim for remuneration (incl. VAT).

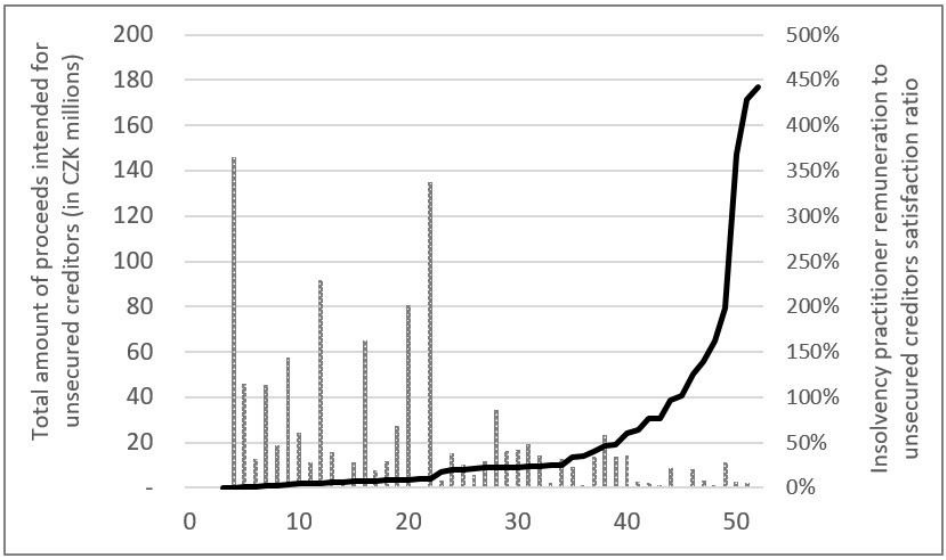
In the given sample, a total of CZK 1.166 billion was paid to unsecured creditors, which averages CZK 24.21 million in each successfully completed reorganization (median CZK 8.95 million). The authors found that, on average, the insolvency practitioner's remuneration was 16.2% of the total volume of financial satisfaction of unsecured creditors. Thus, for each crown earned for themselves, unsecured creditors had to pay one-sixth of a crown to the insolvency practitioner.

Based on the analysis of data projected in the above graph, the authors

[14] KEMPSON, E.: Review of Insolvency Practitioners fees. Report to the Insolvency Service. GOV.UK, Insolvency Service (July 2013). Available from http://www.bristol.ac.uk/media-library/sites/geography/migrated/documents/pfrc1316.pdf.

[15] Reduced due to the fact that data on satisfaction of creditors in some insolvency proceedings were missing.

observed a trend that in reorganization scenarios in which there are insufficient funds left for creditors (e.g., due to preferential satisfaction of privileged creditors) the total remuneration of the insolvency practitioner gets close to the amount of funds for unsecured creditors. In 16% of the cases examined, the amount of remuneration even exceeded this volume, which indicates a systemic problem of the unbearable transaction costs of the reorganization process.




*Graph II. Comparison of the amount of remuneration of the insolvency practitioners and all funds paid to unsecured creditors in 51 successfully finished reorganizations which were terminated between 12/2016 and 09/2021 (data on funds missing in 2 cases). Source: Czech Insolvency Register.*

## 3. SUITABILITY OF FLAT RATE REMUNERATION MODEL FOR RESTRUCTURING PRACTITIONER

The advantage of the flat rate monthly remuneration model was its considered simplicity and predictability. Both debtor and creditors can estimate the amount of such transaction costs of insolvency proceedings and adjust their economic calculation accordingly. A simple arithmetic is sufficient for the insolvency court to calculate the remuneration which does not require a review of other factual circumstances. And even the insolvency practitioner is partially spared the detailed billing of their actions.

However, the flat rate model does not reflect the scope and complexity of the activities performed. In the reorganisations of different debtors (even at different procedural stages of the same reorganization) there arises inevitably a situation where the remuneration is not even sufficient to cover the costs of the insolvency practitioner or, on the contrary, belongs to them, regardless of whether

they carry out any activity in the proceedings. The flat rate monthly model of the insolvency practitioner's remuneration also appears to be economically disadvantageous for ordinary unsecured creditors under certain conditions, as this type of costs may outweigh their yields resulting from the reorganization process.

The restructuring practitioner generally does not affect the economic performance of the debtor. The nature of their function of performing *ad hoc* tasks on behalf of the restructuring court has no linkage with the time scale (unlike the continuous course of the reorganization). According to the authors, the submitted dilemma would be solved by the model of task fee, which would belong precisely to the fulfilment of specific partial tasks stipulated by law or imposed by the restructuring court. The task fee reflects the real extent of involvement of the restructuring practitioner. From the participants' point of view, this optimizes transaction costs, which can, with a high rate of consensus when effectively negotiating the restructuring plan, effectively minimize (i.e., no restructuring proceedings will be initiated, eliminating the reason for appointing a restructuring practitioner).

The Czech insolvency law does not currently regulate other remuneration models. However, foreign jurisdictions introduced also different approaches. For example, inspiration can also be found in the new German law on stabilization and restructuring frameworks for entrepreneurs (StaRUG)[16] which also represents the transposition of the Directive (EU) 2019/1023. According to StaRUG, restructuring practitioners are remunerated on an hourly basis, which depends on the size of the entrepreneur's business, the nature and extent of the debtor's economic difficulties and the qualifications of the restructuring practitioner and their qualified employees.[17] The number of billed hours must be "reasonable" (§ 81 StaRUG) and the hourly rate must not exceed EUR 350 for the personal work of the restructuring practitioner, or EUR 200 for the work of a qualified employee [§ 81 (3) StaRUG]. The restructuring court may initially limit the maximum amount of the budget and the number of billable hours [§ 81 (4) StaRUG] and adjust it depending on the course of the proceedings.

This approach differs substantially from ordinary rules for remuneration of insolvency practitioners. The deviation is justified by the fundamentally significantly different tasks and activity profile of a restructuring practitioner.[18] Unfortunately, no current data allowing evaluation of such solution can be possibly obtained due to very recent enactment. Yet, as any other approach, even time-cost (hourly rates) remuneration model shows significant weaknesses. Seng and

[16] The reason of seeking for inspiration in German remuneration scheme corresponds with the fact that even DAPR was influenced by German transposition norm accordingly to official exploratory memorandum of DAPR. Also see Unternehmensstabilisierungs- und -restrukturierungsgesetz, 22. 12. 2020 BGBI. I 2020, p. 3256 (StaRUG).

[17] SCHULTZE & BRAUN: Insolvency and Restructuring in Germany. Yearbook 2021, p. 50.

[18] LUDWIG, S.: § 81. In: WOLGAST, M. – GRAUER, P.: *StaRUG. Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen. Kommentar.* 1st ed. 2021.

Kiu perceive a significant risk of market failure when control safeguards over expenditure reports are weak. Then, time-costing may end up as a "licence to print money".[19] LoPucki and Doherty[20] called this phenomenon a "billing opportunity" and statistically proved higher fees and expenses in specific cases (forum-shopping cases).

Dickfos[21] perceives more risks emanating from misbalanced remuneration systems. Excessive levels and poor disclosure of practitioners´ remunerations reduce public´s confidence and trust in the profession. On the other hand, low remuneration rates do not attract good quality professionals and contributes to a higher corruption potential. Dickfos warn before exclusive creditor approval mechanisms as creditors logically tend to prefer own yields over transaction costs. As a result, a balanced system should rather be introduced. Steele, Wee and Ramsey[22] concluded that such balances and counterweights may be based on expenditures caps over which an approval of the court should be requested.

## CONCLUSION

Both compared professions are entitled to remuneration for the performance of the function determined by public law regulations. The remuneration of the insolvency practitioner in reorganizations is based mainly on the model of monthly flat rate fees. The method of determining the remuneration of the restructuring practitioner has not yet been officially presented.

The authors tend to conclude that the model of a flat rate monthly remuneration (as used in reorganizations) should not be considered as a suitable inspiration for setting the remuneration model of restructuring practitioner, especially due to the absence of continuous management tasks. More suitable alternatives could be either the German model of a structured hourly rate, or preferably, a task fee reflecting the presumed complexity of performing the function of restructuring practitioner in individual proceedings.

The authors have presented their conclusion as an initial contribution to the forthcoming discussion over restructuring the practitioner´s remuneration scheme which needs to be developed in 2022.

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Directive (EU) 2019/1023 of the European Parliament and of the Council od 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132.

GERMANY Unternehmensstabilisierungs- und -restrukturierungsgesetz, 22.12.2020 BGBI. I 2020, p. 3256 (StaRUG).

# SECTION IV
# EUROPEAN AND INTERNATIONAL LEGAL ASPECTS OF DOING BUSINESS

# Position and role of internal audit within the business group controlling mechanisms

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***Abstract:*** *The aim of this paper is to define the position and the role of the internal audit within the controlling mechanisms of a business group as these are supplementary to supervisory functions. In some jurisdictions, internal audit forms an essential function with respect to the corporate governance. However, powers of the internal audit body or function are affected and vary due to its position in various legal structures. Within the EU (and Swiss) legislative framework, internal auditing provides independent assurance that governance and internal control processes are operating effectively. As a controlling mechanism, internal audit is in general more efficient if established under the powers of the statutory body than entrusted with the supervisory body. The supervisory powers of internal audit on the group level in the various possible legal structures set forth by the law are, however, mostly dependent on the recognition of the internal audit powers by the local group entities.*

***Keywords:*** *internal audit, control mechanism, business, group, corporate.*

## INTRODUCTION

This paper focuses on the internal audit ("IA") and its role within the individual companies in a business group as it defines the essential functions of internal audit and further compares its establishment options together with various function localizations[1].

IA function is further analysed from the EU, Swiss and Czech law perspective with the aim to provide a general overview of the IA approaches and means towards providing for its effectivity and accountability.

## 1. INTERNAL AUDIT AS A FUNCTION

Before linking the IA function to a specific company's body, it is crucial to define the role and purpose of the IA as a process. In general, "*internal auditing is an independent, objective assurance and consulting activity designed to add*

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*value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.*"[2]

Duties vested in the IA function are highly connected to duly compliance with the corporate governance rules of the company (and a business group as a whole). IA supports the governing body of a company entrusted with the supervisory remit in order to meet the corporate governance rules requirements.[3] It is essential for a company to implement the respective controlling mechanisms ensuring fulfilment of all of the regulatory and legal requirements.

## 2. ROLE OF THE INTERNAL AUDIT

The essential role of the IA, within the individual members of a business group (controlling and controlled entities) aiming at meeting the general objectives and interests of a business group, is to independently and objectively:

- **evaluate the adequacy, effectiveness and efficiency of a company's (group) system of internal control** – the evaluation role of the IA correlates with its' position within the company's controlling mechanisms as it shall provide: (i) unbiased and independent insight of the company's ability to comply with the legal requirements; together with (ii) effectiveness overview of risk management, control and governance processes implemented by respective company's bodies (e.g. auditing committees established under a statutory or supervisory body etc.);
- **identify opportunities to improve the effectiveness of risk management, control and governance processes** – by e.g. creating an internal control framework and acting in line with recognized international standards for IA practice;[4]
- **support the company business activities in order to take "smart" risks and prevent any undesirable events from occurring** – including risk acceptance and conducting business operations in accordance with

[2] THE INSTITUTE OF INTERNAL AUDITORS. Mandatory Guidance. Definition of internal auditing [online]. 2021 [viewed 3 October 2021]. Available from: https://global.theiia.org/standards-guidance/mandatory-guidance/Pages/Definition-of-Internal-Auditing.aspx.

[3] Brender, N., Yzeiraj, B., & Fragniere, E. The management audit as a tool to foster corporate governance: an inquiry in Switzerland. *Managerial Auditing Journal*. [online]. 2015, 30(8/9), 790. [viewed 7 November 2021]. Available from: https://doi.org/10.1108/maj-03-2014-1013.

[4] THE INSTITUTE OF INTERNAL AUDITORS. The Three Lines of Defense in Effective Risk Management and Control. IIA Position Paper [online]. 2013. [viewed 7 November 2021]. Available from: https://global.theiia.org/standards-guidance/recommended-guidance.

the law, e.g. under the business judgement rule[5] and duty of care[6] applicability and in line with IA support function findings.[7]

As the IA forms the third line of defence according to the Three Lines of Defence model (next to the Operational Management and Risk Management and Compliance function),[8] a company represented by the governing body shall ensure, to the extent permittable by the law, that the IA has all the necessary powers to fulfil its crucial role (including being equipped with sufficient knowledge and skills).[9] The remit of IA might be affected by positioning the function within the company's legal structure (entrusting one of the compulsory bodies with IA function or establishing a specialized body to carry out the IA activities).

It shall be the governing body's key priority to establish the IA function to meet the corporate governance requirements and the IA International standards (as the IA can become a valuable business partner for the management function) as the IA function assists the governing body to comply with its legal obligations and assuring duly corporate governance.

## 3. INTERNAL AUDIT IN A LEGAL STRUCTURE OF A COMPANY

When considering a position of the IA function within the company's legal structure (and group's controlling mechanism), it is essential to combine the following basic requirements and conditions to identify the potential IA localization:

- duly fulfilment of the IA function activities/tasks;
- scope of supervisory activities of the company's compulsory bodies that might interfere with/assume/cover the IA function; and
- statutory legal requirements for establishing the IA function (incl. the remit, form, accountability etc.).

With respect to the above, the IA (as an activity/process) might be:

- entrusted with the **statutory body** (i.e. Executive Board/Senior Management) of a company, where the efficiency arises from the accountability

[5] BAYLESS, Manning. The Business Judgement Rule in Overview. Symposium: Current Issues in Corporate Governance. *Ohio State Law Journal*. [online] 1984, vol. 45, Issue 3, 615-628. [viewed 3 October 2021] Available from: https://heinonline.org/HOL/P?h=hein.journals/ohslj45&i=627.

[6] BRUNER, Christopher M. Is the Corporate Director's Duty of Care a 'Fiduciary' Duty? Does it Matter? *SSRN Electronic Journal* [online]. 2013. ISSN 1556-5068 [viewed 3 October 2021]. Available from: doi:10.2139/ssrn.2237400.

[7] MUSTAFA, Fairouz Mohammed, and Munther Barakat AL-NIMER. The Association between Enterprise Risk Management and Corporate Governance Quality: The Mediating Role of Internal Audit Performance. *Journal of Advanced Research in Law and Economics* [online]. 2018, 9(4), 1387. ISSN 2068-696X [viewed 4 October 2021]. Available from: doi:10.14505//jarle.v9.4(34).27.

[8] THE INSTITUTE OF INTERNAL AUDITORS. Op. cit Sub 3.

[9] VADASI, C., BEKIARIS, M., & ANDRIKOPOULOS, A. Corporate governance and internal audit: an institutional theory perspective. *Corporate Governance: The International Journal of Business in Society*. [online]. 2019, 20(1), 175–190. [viewed 7 November 2021]. Available from: https://doi.org/10.1108/cg-07-2019-0215.

and fiduciary duties of members of statutory body;[10]

- entrusted with the **supervisory body** (e.g. supervisory board) of a company as a supervisory body in general supervises the business operation activities performed by the Statutory body (i.e. Executive Board) and the general affairs of the company and its enterprise, which is prevalent in the German-speaking countries in connection to the two-tier system of a company's internal structure;[11]
- entrusted with an **optional body** of a company established solely for the purposes of the IA (reflecting statutory requirements for an essential structure of a company).

### 3.1. Internal audit entrusted with a statutory body

The duties and the remit of a statutory body generally (from the Czech and Swiss law perspective) lay within managing the business activities of a company and further powers entrusted to the statutory body by: (i) the law; (ii) the Articles of Association; or (iii) a decision of a public authority.[12]

Considering the ability of the members of a statutory body to delegate the managerial powers: (i) among its members resulting in horizontal delegation or division of powers inside the statutory body; and/or (ii) inwards the company resulting in vertical delegation, the IA is eligible to be established as: (i) an advisory board or a committee to the statutory body; or (ii) an IA department with a respective company division (e.g. reporting to Senior Management / CFO etc.).
If analysing the remit of the members of a statutory body under the Swiss law, the non-transferable and inalienable duties of members of the statutory body may comprise of:

- **management of the company** including issuing all the necessary directives, preparations for a general meeting of a company and implementing its resolutions;

[10] DI GENNARO, Mauro. The Role of Internal Audit on Corporate Governance. Case: Fiat Group. *International In-House Counsel Journal*. [online]. 2007, vol. 1, no. 2, Winter 2007, [i]-[vii]. [viewed 3 October 2021]. Available from: https://heinonline.org/HOL/P?h=hein.journals/iihcj1&i=27.

[11] KRANE, Ronja, EULERICH, Marc. Going Global: Factors Influencing the Internationalization of the Internal Audit Function. *SSRN Electronic Journal*. [online] 2019. [viewed 7 November 2021]. Available from: https://doi.org/10.2139/ssrn.3385346.

[12] See for example: Article 39 of Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32001R2157; Section 716 of SWISS CONFEDERATION 220 Federal Act of 30 March 1911 on the Amendment of the Swiss Civil Code [220 Bundesgesetz betreffend die Ergänzung des Schweizerischen Zivilgesetzbuches]; or Section 162 and 163 of CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code [zákon č. 89/2012 Sb., občanský zákoník].

- **determination of the company's organisation** (which reflects the horizontal and vertical delegation of powers);
- organisation of the accounting, **financial control** and financial planning systems as required for the management of a company;
- appointment and dismissal of persons entrusted with managing and representing the company;
- **supervision of persons entrusted with managing a company**, in particular with regard to compliance with the law, articles of association, operational regulations and directives (as this obligation is strictly connected to accountability for managing the company on delegated levels).[13]

The statutory body is eligible to assign some of its responsibilities (preparation and implementation of its resolutions; monitoring of transactions etc.) to committees or individual members. However, the assurance of an appropriate reporting system or activity to members of the statutory body implementation must be ensured.[14]

IA function established as an advisory board/auditing committee, reporting to the statutory body being entrusted with the controlling (supervisory) powers (i.e. in one-tier system of company's structure), has a strong authorization for performing its activities on behalf of a statutory body.[15]

### 3.2. Internal audit entrusted with supervisory body

Duties of a compulsory supervisory body generally lay within the supervision over: (i) the powers of the statutory body; and (ii) the activities of a company as such. The main role of a supervisory body is to carry out control over other bodies within its authorization and activate controlling mechanisms when required by the law or the Articles of Association.

With respect to an organization of a supervisory body (Supervisory Board), it is eligible to establish committees or advisory boards in order to support its controlling mechanism function and enhance effective control within the supervisory body authorization.[16] Furthermore, it might be required by the law to establish an audit committee if specific conditions are met (i.e. in case of an entity

[13] See e.g. Section 716a(1) of SWISS CONFEDERATION 220 Federal Act of 30 March 1911 on the Amendment of the Swiss Civil Code [220 Bundesgesetz betreffend die Ergänzung des Schweizerischen Zivilgesetzbuches].

[14] See e.g. op. cit Sub 7, Section 716a(2).

[15] CLARK, W. Myrtle, GIBBS, E. Thomas, SCHROEDER, G. Richard. How CPAs evaluate internal auditors. *The CPA Journal (pre-1986)*. 1981, Vol. 51 No. 7, p. 10.

[16] LASÁK, Jan. In LASÁK, Jan, Jan DĚDIČ, Jarmila POKORNÁ and Zdeněk ČÁP. *Zákon o obchodních korporacích: komentář*. 2. vydání. Praha: Wolters Kluwer, 2021, Section 446, 2566. ISBN 978-80-7598-881-2.

of public interest[17])[18]. This requirement was introduced by the EU Directive on statutory audits of annual accounts and consolidated accounts ("**EU Audit Directive**")[19] and instantly affected more than 300 000 companies with the requirement of the statutory audit performance, at the time of its effect.[20]

Legislation of the Czech Republic developed due to the EU Audit Directive as the Czech legislator adopted the Auditor's Act ("**Auditor's Act**")[21] in order to achieve a duly transposition of the EU Audit Directive. As mentioned above, the obligation to establish an audit committee correlates with the quality of a company (entity) holding public interest. Such approach was criticized by ČERNÁ[22] as not the Auditor's Act nor any other legal Act determined the position of the auditing committee [considering its remit if: (i) entrusted with a company's newly established body existing apart from a statutory or supervisory body; or (ii) established as a function under a compulsory body of a company) within the company's structure. DĚDIČ and PIHERA[23] further analysed the establishment of an audit committee (i.e. a mandatory requirement of the Auditor's Act in case of public interest entity) from a localization perspective. This forms a crucial issue compared to the general practice of localizing the IA function in Switzerland, where it is commonly entrusted with an audit committee of a company.[24]

[17] See also Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0537.

[18] SEVERA, Tomáš. Povinnost zřídit výbor pro audit a kdo ji má. *Interní auditor*. [online]. 2016. 2/2016. 2-6. [viewed 3 October 2021]. Available from: https://www.interniaudit.cz/download/diskuze/pdfclanky/diskuse.12-povinnost-severa-tomas.pdf.

[19] Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC. [online]. 2006 [viewed 3 October 2021]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32006L0043.

[20] DELOITTE. EU audit legislation. [online]. 2016. [viewed 3 October 2021]. Available from: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Audit/gx-deloitte-eu-audit-legislation-overview.pdf.

[21] Act No. 93/2009 Sb., on Auditors and amendment of some of the Acts (Auditors Act) [Zákon č. 93/2009 Sb., o auditorech a o změně některých zákonů (zákon o auditorech)].

[22] ČERNÁ, Stanislava. Výbory pro audit v zahraničních a tuzemských akciových společnostech. *Obchodněprávní revue*. 2010, vol. 8, 223-232.

[23] DĚDIČ, Jan, and Vlastimil PIHERA. Odpovědnost členů výboru pro audit. *Auditor*. [online]. 2(2020), 12-23. [viewed 3 October 2021]. Available from: https://www.kacr.cz/file/6004/2020-auditor-2.pdf.

[24] DELOITTE. *Audit Committees in Switzerland, Insights and Perspectives*. [viewed 7 November 2021]. Available from: https://www2.deloitte.com/content/dam/Deloitte/ch/Documents/audit/ch-en-audit-audit-committees-in-switzerland.PDF.

### 3.3. Internal audit entrusted with a facultative body

The establishment of an optional body within a company's legal structure was already addressed in the Article 1.2 hereof. However, as a possibility to establish an optional body entrusted with the powers of the IA, e.g. in the scope of the Section 44 of the Auditors' Act (Czech Republic), as presumed by the law, prohibition of the delegation of duties (powers) of the compulsory bodies shall be ensured. Therefore, in the context of the duties (powers) of an auditing committee established as an optional body of a company, it can be generally entrusted solely with the duties not overlapping the duties or the remit of a compulsory supervisory body.[25]

## 4. INTERNAL AUDIT RECOGNITION WITHIN A BUSINESS GROUP

Following the establishment of the IA function at the local and global level of a business group, cooperation among the group legal entities shall be ensured by an effective group control mechanism recognition. If established as a compulsory audit committee under the EU Audit Directive (e.g. in Czech Republic under the Auditor's Act), the powers of the audit committee within the business group are carried out in accordance with the law and respective legal authorisations.

In case the business group wishes to establish the IA function in all of its individual entities (i.e. controlling and controlled entities) voluntarily without a legal requirement, it shall be ensured that the IA function remit is recognized across the group. In order to achieve such a recognition, the controlling entity may use its respective powers to enforce and support the position and powers of the IA function in controlled entities (i.e. subsidiaries of the controlling entity) including the factual and legal influence arising above all from performance of shareholder's powers.[26]

The establishment of a global IA function with remit to perform the IA activities in local entities (i.e. foreign subsidiaries or group branches) reflects an issue of a centralization and internationalization of the IA function. As a group level (centralized) IA function might provide more uniformed standards and objective approach (due to a risk of loyalty of internal auditor towards the audited local entity being absent if performed internationally) in carrying out of the IA

[25] See DĚDIČ, PIHERA (2020), op. cit. sub 16; and Section 163 of CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code [zákon č. 89/2012 Sb., občanský zákoník].

[26] BÁLEK, Jiří. Kontrola prosazování koncernových zájmů ze strany orgánů řídící osoby. In: ŠKRABKA, Jan and VACUŠKA, Lukáš (ed.). Law in Business of Selected Member States of the European Union. Proceedings of the XII International Scientific Conference. Prague: TROAS, s.r.o., 2020, 12-22. ISBN: 978-80-88055-10-5.

activities efficiently,[27] a global internal auditor would potentially lack the necessary knowledge of local legal requirements subject to the IA reviewed scope of activities. However, a global IA function can be supported by the local: (i) Second Line of Defence (Risk Management and Compliance functions) if specific knowledge of local legal requirements is necessary and; (ii) statutory body (which provides the authorization for the IA activities on local level and delegates tasks towards the local functions in order to ensure that a necessary cooperation is being provided – support of Compliance and other support functions with respect to data collection/handover approvals etc.). In comparison, the supervisory body generally: (i) lacks the remit to access all the company's documentation (as a cooperation of the statutory body would have to be requested; and (ii) is not eligible to assign tasks/activities to company's business or supporting functions.

In line with an approach of the practise and the legal structure of international business groups, the most effective approach is, in my opinion, ensuring the recognition of the IA function by its establishment as a functional division (vertical delegation) accountable to the statutory body (if established without a legal requirement). The statutory body of a controlling entity shall be eligible to ensure that the general IA approach is adopted by the general meetings on the global and local levels (incl. the IA action and remediation plan). Therefore, the statutory body of a controlling entity (if performing the powers of the general meeting of controlling entities – reliant on the ownership structure of a group) shall be eligible to coordinate the recognition of the IA function across the whole business group.

With respect to the liability/accountability for the IA findings and reporting obligations, the principles of superiority (on the global/controlling entity level) and subordination (on the local/controlled entity level) shall represent an immense role in adopting remediation steps as the global IA findings might be subsequently reported to members of local statutory bodies to adopt respective remedial measures. If findings within the remit of a global IA function identify a breach in the obligations of the governing body members on a local controlled company level (i.e. the governing body's role of a guardian of corporate governance is identified as breached), a global controlling entity (shareholder) shall be authorized (within its discretion) to exercise its powers through the local general meeting resulting in recall of the respective governing body member and appointment of a new member (depending on the severity of the IA finding).

## CONCLUSION

The IA represents an essential function within the business group and contributes to the general compliance and opportune identification of risks, as it supports the role of a guardian of corporate governance lying with the governing

[27] KRANE, EULERICH. (2019). Op. cit Sub 10.

body of a company. Various legal frameworks provide companies (business groups) with the option to establish the IA function based on personalized requirements of companies (e.g. voluntary establishment of auditing committee).

In order to ensure effective and functional control system represented by the IA, it is necessary for the IA function to be: (i) established under a statutory body rather than a supervisory body, as a statutory body provides strong authorization for the IA recognition within the organization together with a necessary enforcement of a cooperation provided from the business and supporting functions of a company); and (ii) recognized by the local and global statutory bodies in line with the control action plan adopted by the respective general meetings.

*De lege ferenda*, the Czech legislation could adopt a clearer approach on localization of the IA function within the company's structure and further introduce a regulation of a company's internal reporting (regarding the delegation of powers/agency) as stipulated by the Swiss law.

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# The question of criminal liability of commercial companies under international law

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***Abstract:*** *The absence of criminal liability of companies under international law has created a well-documented accountability gap. Some multinational companies, in their pursuit of profit motives, make decisions that lead to criminal conduct. The United Nations Framework of Analysis for Atrocity Crimes shows an increase in the involvement of multinational companies in crimes of atrocity. The current international legal framework and the Rome Statute of the International Criminal Court pose a challenge in the prosecution of these companies as it does not recognise legal persons. However, the breakthrough comes from a decision to assert jurisdiction over legal persons by the Appeals Panel of the Special Tribunal for Lebanon. Even though the scope of this decision is limited, it is still a substantial shift in how the criminal liability of companies is perceived in international law. This paper analyses these recent developments and highlights possible solutions to end the accountability gap.*

***Keywords:*** *Criminal liability of companies, international law, Rome Statute of the International Criminal Court, legal persons, crimes of atrocity, Special Tribunal for Lebanon.*

## INTRODUCTION

Commercial companies have existed for centuries they can be traced back to the Roman Empire.[1] Since their very inception profit making has been a driving factor if not the main purpose of most of these companies. In pursuit of their profit motives some of these companies have engaged in egregious conducts. Through time and again we witness companies that prioritise public good. However, there has been an increasing trend of companies that are privately owned and are architected to maximise the profit gain for themselves and their shareholders.[2]

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[2] TRUITT, Wesley B. The corporation (Greenwood Guides to Business and Economics). Greenwood Press, 2006.; WEISMANN, Miriam F. Corporate Crime and Financial Fraud: Legal and Financial Implications of Corporate Misconduct. Chicago: American Bar Association, 2012.

In popular culture a good business deal is one which yields large profits. Sometimes these deals demand sacrifice of social well-being and conscionable conduct in exchange of profit gains. Unfortunately, history has provided us with examples where companies have made these bad deals disguised as good. "The debate over whether the International Criminal Court should have jurisdiction over corporations has persisted over the years, despite the failure of the legal persons proposals at Rome".[3] However, it is important for us to understand that a corporation who commits a crime should be held accountable in some way as individuals engaged in a similar act are. Hence, both should be held accountable for their actions before the law.

When a nation goes to war, everyone is urged to support the war effort. Some do it out of patriotism some out of necessity and some are coaxed into it. Natural persons of that nation are drafted into armed forces and likewise legal persons utilise their corporate abilities to help the state. In this paper we will discuss how some companies helped their home states by involving themselves into colonisation — apparently advancing national and patriotic aims, however, never at loss.[4]

Dwight D. Eisenhower, the 38th president of the United States, in his farewell address warned the world about a military-industrial complex which could potentially grow and could possibly wield disproportional influence if went unchecked.[5] He was outlining the synergy between corporation, military and the government fuelled by the cold war. This synergy we were warned about 50 years ago has cemented itself and has outlived the conflict that gave birth to it.

During the Second World War in Hitler's Germany the ensemble of corporate activity, military necessity and government counsel manifested the worst form of this synergy. German companies operated in accordance with the legal framework of their home government which was the Third Reich. Therefore, the immoral activities these companies were involved in were legal under the laws of their home country. However, they were still in violation of international laws.

At one point during the war one out of every five worker in Germany was a forced labourer.[6] By 1944 the total number of these workers was 10 million, 6.5 million out of this were civilian forced labourers, 2.2 million of which were prisoners of war, and 1.3 million were from the camps that were situated outside

[3] KYRIAKAKIS, Joanna. Corporations before International Criminal Courts: Implications for the International Criminal Justice Project. Leiden Journal of International Law, 2016, 30(1), 221–240.
[4] KEENEY, Sandy, The Foundations of Government Contracting, Journal of Contract Management 2007(7), 7-19.
[5] EISENHOWER, Dwight D. Farewell Address to the Nation, January 17, 1961. In: Militarization [online]. Duke University Press, 2019. ISBN 9781478007135 [viewed 9 October 2021]. Available from: doi:10.1215/9781478007135-005.
[6] BREYER, J.C. & SCHNEIDER S.A. Forced Labor under the Third Reich: Part One, Nathan Assoc. Inc., 1999 [online]. Previously available from http://www.nathaninc.com.

Germany proper.[7] As a result after the war ended German companies started paying reparations to the victims and survivors.[8] Volkswagen built a $12 million fund in order to compensate forced labourers they used.[9] This was "the first time a German company acknowledged its 'moral and legal responsibility 'to compensate Nazi-era slave laborers."[10] This article explores crucial historical events and their contexts in order to understand the legal treatment of companies that engage in such wrongdoings. Furthermore, the examples discussed in this article highlight the lack of legal framework and criminal enforcement against commercial companies as companies actively participate in crippling down the quest to seek and demand justice against them.

## 1. HISTORICAL BACKGROUND OF COMPANIES AND THE LACK OF CRIMINAL LIABILITY

This section of the paper highlights the crimes and atrocities committed by corporation throughout the course of history. It starts off by discussing the role East India Company played in colonisation and the immoral conduct. It engaged in as a commercial company, yet it was never held criminally liable. Moreover, this section provides a background on the history of criminal liability in international law through exploring the case of I.G. Farben and how it would have been easier to prosecute the accused if the company was held liable for its crimes as a legal person. Furthermore, this section discusses the present-day situation in Myanmar, and how foreign commercial companies are contributing to a potential genocide without fears of being held accountable for their actions.

### 1.1. East India Company

The British East India Company (EIC) contributed extensively to Great Britain´s colonisation of India. They formed a synergy between the joint-stock company and the government in their pursuit of benefiting the home country by harnessing natural resources and labour from colonial activity.[11] This model was influenced by the Dutch. The attitude of the EIC towards India can be understood from what Sir John Kaye wrote in 'The Administration of the East India Company' "The servants of the Company had been for nearly two centuries regarding the natives of India only as so many dark-faced and dark-souled Gentiles, whom

[7] *Id.*
[8] *Id.*
[9] SALAZAR, Barbara. The Holocaust—Recovery of Assets from World War II: A Chronology (May 1995 to present), CRS Report for Congress, 2000 (57), 35-39.
[10] *Id.*
[11] TULLY, Stephen. Corporations and international lawmaking. Boston/Leiden: Martinus Nijhoff Publishers, 2007.

it was their mission to over-reach in business, and to overcome in war."[12] This architected the foundational approach for EIC's trade in the British Raj which led to the predictable, if not foreseeable, abuses and atrocities. "Torture was facilitated, systematized, and ultimately sanctioned by first the East India. Company and then the Raj because it benefitted the colonial regime".[13]

In 1827 J.R. McCulloch regarded EIC as "A company which carries a sword in one hand and a ledger in the other—which maintains armies and retails tea, is a contradiction."[14] EIC claimed that its purpose was commerce not combat, Initially the company did not make territorial advances, or tried to colonise Asia. However, from its inception the EIC used force in order to both defend itself and achieve profit motives. Eventually the company established that the dominance of EIC was necessary, "driven both by EIC economic interests and the idea that to 'stop is dangerous; to recede ruin. 'From the British perspective, defeating India's armies handily enhanced their reputation among local rulers, while defeat or retreat had the opposite effect. This meant terrorizing not only the enemy but also local populations during battle."[15]

When it comes to the extent of mercilessness EIC reached in order to achieve their motives, some parallels can be drawn with the tactics adopted by Ghengis khan in his campaign to expand the Mongol Empire towards the west and the tactics of the Islamic state in its attempt to establish a caliphate.[16] However, the major difference between the three is of incentive. Where in the first example the motive is traditional imperial aims, the motive in the second example is religious dominance and the motive in EIC's case is strengthening of its economic dominance in advancement of its corporate interest.

The unification of the British military forces and the EIC was utilised to commit acts that resembled genocidal conduct, this can be better understood by studying when "[t]he future Duke of Wellington, known for his humanity during the Napoleonic Wars, ordered his troops to burn entire villages and loot them completely during a campaign in Malabar in 1800."[17] In many instances even the EIC did not shy away from wielding the IEC army which was "built around a strong cadre of British officers and large numbers of Sepoys, who were the backbone of the British forces in India."[18] In the House of Commons debate a Member

[12] KAYE, John William. The Administration of the East India Company: A History of Indian Progress. London: R. Bentley, 1853.
[13]BROWN, Mark. Colonial states, colonial rule, colonial governmentalities: Implications for the study of historical state crime. State Crime Journal, 2018(7)2, 173.
[14] BLANKEN, L.J. Rational Empires: Institutional Incentive and Imperial Expansion. Chicago/London: The University of Chicago Press, 2012.
[15] CROWE, David M. War crimes, genocide, and justice [online]. New York: Palgrave Macmillan US, 2014.
[16] THOMPSON, Lindsay J. *Colonialism, in Encyclopedia of Business Ethics and Society*, Vol. 1, pp. 347–349 (KOLB, Robert W. ed., 2008).
[17] CROWE, David M. War crimes, genocide, and justice [online]. New York: Palgrave Macmillan US, 2014.
[18] *Id.*

of Parliament in 1856 even ascribed murder and torture to the company.

*[House of Commons Debate, April 18, 1856, Statement of Mr. Murrough (MP-Bridport).] Take, again, the case of the Maharanees of Nagpore, which is a case of torture, […] On the death of the late Maharajah, his widows, in the undoubted exercise of their rights, according to Hindoo law, proceeded to nominate his infant successor to the vacant gadee, upon which British troops marched into Nagpore, threw the Ministers and the relatives of the late Sovereign into the common gaol, swept away the private property of the widows to the extent of two millions and a half, filled the palace of these illustrious ladies with Sepoys, under the command of a British officer, and deprived them of the means of even exercising the rights of their religion until they had extorted from them a release of their legal rights. Sir, two of these ladies are now no more—[…], they perished by poison administered by their own hands, or by the servants and at the instance of the Directors, is one of those fell mysterious secrets which fiends, both human and unearthly, have conspired to consign to the dark archives of hell; but be this how it may, the Company are equally their murderers.*[19]

The EIC was also involved in drug-running. Presumably without EIC's involvement the opium wars would not have taken place. While overtly condemning and criticizing the opium trade.[20] During the early nineteenth century EIC managed to smuggle substantial amounts of opium into China through proxy vessels.[21] The EIC orchestrated the addiction of millions of Chinese people, in order to build a market for opium which they could then profit from selling the drug. This was an extremely vicious and vile act committed by the company for profit motives. The EIC sold opium at auctions for almost four times more than it would originally cost them to grow and process. In the late 18th century, the revenue brought in by opium alone was £39,000. Two decades later, it had ballooned to £250,000 just from China. The company broadened the opium market and amplified opium production in India to cater the drug to the Chinese people. From this transaction India received the cash flow required to purchase British textile.[22] When EIC stopped the drug trade the Chinese mass addiction was already at its prime it had utilised its full extent and this ended up in crippling the whole empire.[23] the company's illicit drug trade resulted in degradation of a whole society.[24] "East India Company's monopoly over China trade was abolished in

[19] Quotation based on KELLY, Michael J., and Luis MORENO-OCAMPO. Introduction. In: Prosecuting Corporations for genocide. Oxford University Press, 2016, p. 26.
[20] AUNE, Bjorn Robertstad. The Maritime Trade in Illicit Drugs. Thesis. London School of Economics, 1989 [online], 1989 [viewed 15 November 2021]. Available from http://etheses.lse.ac.uk/2084/1/U550164.pdf, at p. 40.
[21] *Id.*
[22] KELLY, Michael J., and Luis MORENO-OCAMPO. Introduction. In: Prosecuting Corporations for genocide. Oxford University Press, 2016.
[23] AUNE, Bjorn Robertstad, *op. cit.*, p. 40.
[24] *Id.*

1834."[25]

Even after all that EIC did there was little to no reprimand for the actions and crimes committed. Eventually, Warren Hastings was impeached. The trial went on from 1788 to 1795, the tickets to the trial were sold to celebrities and royalties. However, Hastings was ultimately acquitted.[26]

### 1.2. I. G. FARBEN

"Since 1916, eight of the main German chemical firms were joined together in what was called 'a community of interest'—'Interessen Gemeinschaften 'or abbreviated 'I.G.'"[27] The Farben, possessed" nearly a total monopoly of German chemical production at the beginning of World War II and, undoubtedly, was one of the main cartels in the world."[28] Initially Farben had an anti-Nazi stance. However, "when the movement to war was defined, it converted itself into one of Hitler's most powerful allies as the fuelling impulse of the German war machine.".[29] Farben made numerous scientific discoveries which played a major role in the war plan of the Nazis, one of them being the production of gasoline and synthetic rubber out of coal.[30]

In 1945 an extensive study on the involvement of Farben in the war was carried out by Pentagon and was submitted to the Congress. According to that study "Without I.G.'s immense production facilities, its far-reaching research and world-wide economic power, the German war could never have been waged."[31] After the war, Nazi war criminals were prosecuted at the international Military Tribunals held at Nuremberg also called the Nuremberg Trials. "The trial brought to light the company's deep involvement in Nazi crimes".[32] The second Tribunal's job was to prosecute Nazi industrialist unlike the first Tribunal that only prosecuted high ranking Nazi leaders. The second Tribunal included the Farben corporate leaders.[33] "All of the defendants [in the *Farben* case] were indicted for the

[25] GAO, Hao. Understanding the Chinese: British merchants on the china trade in the early 1830s. Britain and the World, 2019, 12(2), 151–171.
[26] UK PARLIAMENT. The East India Company and the public opinion [online]. 2021 [viewed 15 November 20201]. Available from https://www.parliament.uk.
[27] ZUPPI, Alberto L. Slave Labor in Nuremberg's I.G. Farben Case: The Lonely Voice of Paul M. Hebert. Lousiana Law Review 2016, 66(2), pp. 495-526
[28] *Id.*
[29] *Id.*
[30] *Id.*
[31] US CONGRESS. Eliminations of German Resources for War, Hearings Before a Subcommittee of the Committee on Military Affairs, 79th Cong. 978 (1945). Available from https://archive.org/stream/bub_gb_ 5XnsAAAAMAAJ#page/n3/mode/2up.
[32] JESSBERGER, Florian. On the origins of individual criminal responsibility under international law for business activity: IG Farben on trial. Journal of International Criminal Justice, 2010, 8(3), 783–802.
[33] KELLY, Michael J., and Luis MORENO-OCAMPO. Introduction. In: Prosecuting Corporations for genocide. Oxford University Press, 2016.

planning, preparation, initiation and waging of wars of aggression, and invasions of other countries (count one); plunder and spoliation (count two); slavery and mass murder (count three); and common plan of conspiracy (count five)."[34] Additionally, "[a]ll of the defendants, with one exception, were members of the German Labor Front, most of them belonged to the Nazi Party, and three were additionally indicted for membership in the SS (count four)."[35] Farben was not prosecuted as a company. However, this decision was political, and not legal:

Individual liability of owners was favoured over corporate criminal liability at Nuremberg, the prosecution staff at Nuremberg explored this with utmost sincerity and "never rejected as legally unsound," Jonathan Bush a legal historian explained, "these theories of liability were not adopted, but not because of any legal determination that they were impermissible under international law."[36]

A precedence established in the first Nuremberg trial by the Jackson prosecution staff may have influenced the decision of prosecuting Farben through individual liability of owners and not recognizing its liability as a corporate entity. "Instead, prosecutors in the subsequent proceedings [like the *Farben* case] made a tactical decision to follow the lead of the main IMT tribunal and proceed with trials against individuals."[37]

It would have been far more easy for the Nuremberg prosecutors to prosecute and convict I.G. Farben as a corporate entity and subsequently follow this conviction to prosecute corporate officers for their individual crimes on the basis of their involvement and contribution in the criminal schemes. However, this criminal scheme could only have been established by the conviction of the company as a whole, and not solely based on individual membership in the company. In prosecuting Gestapo officers this was the case. In the first Nuremberg trials Gestapo along with three others were declared to be criminal organizations.[38] However, they were not commercial companies instead their nature was more political and military. Farben and other companies that proved to be the economic stanchion of the war machine were huge companies, but they were never recognised as criminal organizations. The Farben trial resulted in the following conclusion.

Only 13 were convicted out of the 23 accused and the remaining 10 were acquitted. Out of the 23 accused not a single one of them was found guilty of participating in a war of aggression. In regard to spoliation and plundering of foreign property and active participation in slave labour program, convictions for crimes against humanity and war crimes were in order. In comparison to capital

[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] ZIEMBLICKI, Bartosz. Liability of Companies before International Criminal Courts. In: ŠKRABKA, Jan and VACUŠKA, Lukáš (ed.). Law in Business of Selected Member Sta-tes of the European Union. Proceedings of the XII International Scientific Conference. Prague: TROAS, s.r.o., 2020, pp. 129-136.

punishment and life imprisonment, imprisonment between one to eight years was perceived as moderate. As the pre-trial detention time was subtracted from the sentence, the majority of those convicted were freed after only a few months of detention; in 1951 the remaining convicts were granted amnesty.[39]

### 1.3. Myanmar

In Myanmar, the Rohingya Muslim population is being systematically targeted and attacked by the Tatmadaw. The Tatmadaw are the armed forces of Myanmar. They have been attempting to remove the Rohingya Muslims from Myanmar. “Over the last four decades, almost two thirds of its population have fled the country due to state-sponsored ethnic persecution”.[40] In their pursuit of eradicating the Rohingya Identity, the Tatmadaw and the government authorities have resorted to forced displacement, rape, torture, killings and other human rights violations.[41] The United Nations Human Rights Council's Independent Fact-Finding Mission (FFM) noted that in regards to the acts being committed by the Tatmadaw and the government of Myanmar, there seem to be reasonable grounds to classify genocidal intent on the part of the government.[42] The FFM in a different report also recommended that "no business enterprise active in Myanmar or trading with or investing in businesses in Myanmar should enter into an economic or financial relationship with the security forces of Myanmar, in particular the Tatmadaw, or any enterprise owned or controlled by them or their individual members."[43] The Tatmadaw relies on their foreign commercial ties in order to gain revenue that is outside of their military budget. Consequently, foreign companies are becoming a party to the violations of human rights being committed by the Tatmadaw. By doing business with them, foreign companies are strengthening their campaign and indirectly funding expeditions that are in violation of international law.[44] The FFM found out that there are at least fourteen foreign companies that have joint ventures with the Tatmadaw and about forty-four foreign companies that have other types of commercial ties with them.[45] Furthermore, since 2016 an estimated fourteen companies from several states have been involved in providing Tatmadaw with weapons and related equipment; the

[39] KELLY, Michael J., and Luis MORENO-OCAMPO. Introduction. In: Prosecuting Corporations for genocide. Oxford University Press, 2016, pp. 1–14.
[40] SIDHU, Jatswam S. The Rohingya: Myanmar’s Unwanted Minority. European Yearbook of Minority Issues Online, 2021, 18(1), 236–260.
[41] Human Rights Council, Detailed findings of the Independent International Fact-Finding Mission on Myanmar, U.N. Doc. A/HRC/42/CRP.5, (Sept. 16, 2019).
[42] *Id.*
[43] Human Rights Council, The Economic Interests of the Myanmar Military, Independent International Fact-Finding Mission on Myanmar, U.N. Doc. A/HRC/42/CRP.3, (Aug. 5, 2019).
[44] *Id.*
[45] *Id.*

states include Russia, China and Israel.[46] To ensure the financial isolation of the Tatmadaw, FFM urged foreign companies to sever their economic ties with the Myanmar military.[47]

A human rights organisation called the Burma Campaign UK maintains a "Dirty List" consisting of the names of companies that have financial ties with the Tatmadaw.[48] After the release of the list, some companies have severed their ties with the Myanmar military due to political pressure and public backlash. The first company to cut all ties was a Belgian satellite communication company called Newtec. They announced that they would cease commercial ties with a local phone operator called Mytel. The Myanmar military is a stakeholder in the company and partly owns it.[49] Other companies that followed suit include the Western Union, a giant banking services company associated with Myawaddy bank. Myawaddy bank is a subsidiary of the business conglomerate of the Tatmadaw called Union of Myanmar Economic Holdings Ltd.[50] However, there are still quite a few companies that continue to maintain financial ties with the Myanmar military without the fear of being prosecuted or held criminally liable.

## 2. SPECIAL TRIBUNAL FOR LEBANON

This paper discussed the atrocities committed by the East India Company, the trial of I.G. Farben and the economic ties of foreign companies with the Tatmadaw. In all the mentioned cases, no commercial company was ever recognised as a legal person under international law, just like these three examples, no commercial company had ever been tried as a juridical person before any international criminal court until recently, the breakthrough came from the New T.V. S.A.L. and Akhbar Beirut S.A.L. Appeal Decisions.[51] Both cases were brought before the Special Tribunal for Lebanon, and in the first instance, the contempt judge delivered that holding judicial persons criminally liable is not under its jurisdiction. It was Judge Lettieri who delivered the decisions in both cases. Recognising the seriousness of this matter, he granted certification to prosecution on *Proprio motu* to appeal: "whether the Tribunal in exercising its inherent jurisdiction to hold contempt proceedings pursuant to Rule 60bis has the power to

[46] *Id.*
[47] *Id.*
[48] Burma Campaign UK, The Dirty List, https://burmacampaign.org.uk/take-action/dirty-list/.
[49] CARROLL, Joshua, Belgian Company on 'Dirty List' Cuts Ties With Myanmar Military, VOA News (Aug. 12, 2019), https://www.voanews.com/east-asia-pa-cific/belgian-company-dirty-list-cuts-ties-myanmar-military.
[50] LYNN, Kyaw Ye. Western Union 'cuts ties' with Myanmar military's bank, Andolu Agency, [2020]. https://www.aa.com.tr/en/asia-pacific/western-union-cuts-ties-with-myanmar-militarys-bank/1696236.
[51] SPECIAL TRIBUNAL FOR LEBANON. Akhbar Beirut S.A.L, Ibrahim Mohamed Ali Al Amin, STL-14-06/PT/AP/AR126.1. (Jan. 23, 2015).

charge legal persons with contempt".[52]

The *amicus* prosecutor appealed the decision and advocated that the "tribunal has the power to charge legal persons with contempt and that 'the contempt judge erred in ruling to the contrary".[53] The prosecutor reasoned that the tribunal is well within its rights to charge juridical persons as "the *raison d'eêtre* of international tribunals is the fight against impunity, wherever it is found, including as to contempt".[54] Particularly, the prosecutor argued that "international tribunals have repeatedly eschewed narrow, technical interpretations in favour of broader, pragmatic interpretations in the spirit of the fight against impunity, to carry out that fight as effectively as possible".[55] Additionally, the contempt power of the tribunal is broad as it does not stem from Rule 60bis of the Tribunal's Statute. Instead, it derives it off of the inherent power of the tribunal itself. In simple terms, "[e]ven if Rule 60bis had never been adopted and did not exist, the crime of contempt would still exist and the Tribunal would still have full power and jurisdiction to investigate, indict, prosecute and adjudicate such crimes".[56] The appeals panel seemed to be convinced by this reasoning as it concluded that "inherent jurisdiction over the crime of contempt, as opposed to crimes that fall within our primary jurisdiction, is outlined but not confined by Rule 60bis".[57]

The discussion on Rule 60bis is primarily about the interpretation of two words, 'those 'and 'persons'. It states: *The Tribunal, in the exercise of its inherent power, may hold in contempt those who knowingly and wilfully interfere with its administration of justice, upon assertion of the Tribunal's jurisdiction according to the Statute. This includes, but is not limited to the power to hold in contempt any person who: knowingly and wilfully interferes with its administration of justice.*[58]

In Rule 3 the 'Interpretations of the Rules' reads:

*(A) The Rules shall be interpreted in a manner consonant with the spirit of the Statute and, in order of precedence, (i) the principles of interpretation laid down in customary international law as codified in Articles 31, 32 and 33 of the Vienna Convention on the Law of Treaties (1969), (ii) international standards on*

[52] SPECIAL TRIBUNAL FOR LEBANON. Decision on Motion challenging jurisdiction and on request for leave to amend order in lieu of an indictment, New TV S.A.L. and Khayat (STL-14-05/PT/CJ), Contempt Judge, 24 July 2014 (hereafter, 'New TV S.A.L. Decision').

[53] SPECIAL TRIBUNAL FOR LEBANON. Interlocutory Appeal against the Decision on Motion challenging jurisdiction, New TV S.A.L. and AI Khayat (STL-14-05/PT/AP/AR126.1), Prosecution, 31 July 2014 (hereafter, 'New TV S.A.L. Appeal').

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] Decision on Interlocutory Appeal concerning personal jurisdiction in contempt proceedings, New TV S.A.L. and AI Khayat (STL-14-05/PT/AP/AR126.1), Appeals Panel, 23 January 2015 (hereafter, 'New TV S.A.L. Appeal Decision').

[58] SPECIAL TRIBUNAL FOR LEBANON. Rules of Procedure and Evidence. Rule 60bis.

*human rights (iii) the general principles of international criminal law and procedure, and, as appropriate, (iv) the Lebanese Code of Criminal Procedure.*

*(B) Any ambiguity that has not been resolved in the manner provided for in paragraph (A) shall be resolved by the adoption of such interpretation as is considered to be the most favourable to any relevant suspect or accused in the circumstances then under consideration.*[59]

The panel in the appeal decision systematically went over the numerous aids to interpretations mentioned in Rule 3, starting with Article 33(4) of the Vienna Convention. It states, "when a comparison of the authentic texts discloses a difference of meaning, the meaning which best reconciles the texts shall be adopted".[60] Article 3(2) and (3) and 16 of the statute were referred to by the contempt judge in the *New T.V. S.A.L.* decision. The mentioned article concerns the core crimes which come under the jurisdiction of the Tribunal and not contempt. He also pointed out that they contain "gendered language" (his/her). The contempt judge concluded that this pertains only to a natural person. Hence, the Tribunal only has jurisdiction over natural persons as legal persons such as companies cannot have gender.[61]

However, this interpretation given by the contempt judge was asserted to be wrong on this point by the Appeals Panel.[62] There is a 'difference of meaning ' as the English version comprises of "gendered language", but in the Arabic and French versions, such language is absent. By taking this into consideration, the conclusion drawn by the contempt judge on the basis of gendered language leads to neglecting the gender-neutral tone of the other two versions. In comparison, resorting to the Arabic and French version, as the Appeals Panel did, does not ignore the English version as natural persons remain to be included.

Article 31 of the Vienna Convention on the Law of Treaties states 'a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'.[63] In a legal context, according to the Appeals Panel, the meaning of the word person "can include a natural human being or a legal entity (such as a corporation)".[64] This conclusion is in clear contrast with judge Lettieri's interpretation because, according to him, the word 'person 'in this context is exclusive to natural persons.[65]

The court of second instance stated that 'Interpretations of the Rules ' from the Vienna Convention on the Law of Treaties does not limit the definition of the term 'persons 'just to a natural person. Instead, it includes a legal person in

[59] SPECIAL TRIBUNAL FOR LEBANON. Rules of Procedure and Evidence. Rule 3.
[60] Art. 33(4) Vienna Convention on the Law of Treaties.
[61] SPECIAL TRIBUNAL FOR LEBANON. New TV S.A.L. Decision.
[62] SPECIAL TRIBUNAL FOR LEBANON. New TV S.A.L. Appeal Decision.
[63] Art. 31 Vienna Convention on the Law of Treaties.
[64] SPECIAL TRIBUNAL FOR LEBANON. New TV S.A.L. Appeal Decision.
[65] *Id.*

law along with natural persons.[66]

Finally, New T.V. S.A.L. was acquitted, and Akhbar Beirut S.A.L. was sentenced to a fine of 6000 euros. The consequences for the above-mentioned legal persons cannot be called severe. However, it is important to acknowledge the change in approach brought by the cases in the criminal liability of companies under international law. It is clear that commercial companies are not invincible and can be subject to criminal liability under international law.

## 3. SOLUTION TO REDUCE THE ACOUNTABILITY GAP OF COMPANIES

In spite of the fact that the existence of corporate criminal liability is in dispute until now under customary international law, by amending the Rome Statute, the ICC could still supply itself with express jurisdiction in order to prosecute companies. However, amending the Rome Statute would involve hard to achieve negotiations amongst states which can be politically challenging. Furthermore, amendments require approval of no less than two-thirds of States that are conforming to Article 121(3) of the Rome Statute.[67] Moreover, provided the limited resources of ICC and a strict admissibility criterion for bringing international crimes under its jurisdiction, it is wise to ask whether expanding the jurisdiction of ICC over companies will exceed the political and diplomatic costs. Negotiating an elective protocol to the Rome Statute or amending the Statute itself demands extensive negotiations, numerous State Parties would be reluctant to indulge in, as there are states whose economies are powered by multinational companies and their profitability.[68] Protecting their companies by opposing the efforts of getting companies exposed to international criminal liability would hence be in their best interests.

Nevertheless, David Scheffer, U.S.A's chief negotiator of the Rome Statute, believes "there is value in contemplating the possible phrasing of an amendment to the Rome Statute intended to extend the Court's personal jurisdiction over juridical persons".[69] A recommended amendment of Article 25(1)[70] could read: "The Court shall have jurisdiction over natural *and juridical persons* pursuant to this Statute".[71] Furthermore, the amendment of the second line of Article 1[72] could read: "It shall be a permanent institution and shall have the power to

[66] SPECIAL TRIBUNAL FOR LEBANON. New TV S.A.L., Karma Mohamed Tahsin Al Khayat, para. 42, 44.
[67] Rome Statute of the International Criminal Court, Art. 121(3), July 17, 1998, 2187 U.N.T.S. 3, entered into force 1 July 2002.
[68] See SCHEFFER, David. Corporate Liability Under the Rome Statute, Harvard International Law Journal, 2016, 57, 35-39.
[69] *Id.*
[70] Rome Statute of the International Criminal Court, art. 25, July 17, 1998, 2187 U.N.T.S. 90.
[71] SCHEFFER, supra note 68.
[72] Rome Statute of the International Criminal Court, *supra* note 62, at art. 1.

exercise its jurisdiction over *natural and juridical persons* for the most serious crimes of international concern, as referred to in this Statute, and shall be complementary to national criminal jurisdictions. *Any use of 'person' or 'persons' or the 'accused' in this Statute shall mean a natural or juridical person unless the text connotes an exclusive usage.*"[73]

The ICC requires political cover in order to amend the Rome Statute; in order to provide this, the International Court of Justice (ICJ) could present an advisory opinion. The ICJ can do this at the request of the United Nations General Assembly or another agency or body of the United Nations.[74] In the past, the ICJ presented opinions in regards to questions that implicate the Genocide Convention of 1948, although none of them included companies .[75] If the ICJ declares the legality of prosecuting companies and corporates for crimes, it will give legal encouragement to State Parties to amend the treaty and bring criminal liability of companies under the jurisdiction of ICC.[76]

The importance of an amendment like this to the Rome Statute does not solely rest in the criminal liability of companies at ICC. Before adjudication and prosecution can be pursued regarding corporate crimes at the ICC, widening of the jurisdictional requirements and more procedural reforms would likely be required.

## CONCLUSION

There has been an urgent need for corporate criminal liability for a very long time now. This paper chronologically explores the instances of atrocities committed by companies throughout history. What EIC did in India and I.G. Farben in Germany is in the past. However, the situation of Myanmar is not; companies are voluntarily maintaining economic ties with the government that has genocidal intent against Rohingya Muslims. These companies manifest a sense of invincibility as they cannot be held accountable under international law. The accountability gap will continue to exist, and companies will be complicit in heinous crimes until companies can be tried and prosecuted as companies for their immoral conduct in international courts.

In the case of the special tribunal of Lebanon, the consequences faced by the convict were not dire by any means, but the Appeals Panels' decision has brought about a dramatic change in how criminal liability is perceived under international law. Did justice prevail in the case of New TV Sal and Akhbar Beirut

[73] SCHEFFER, supra note 68.
[74] Statute of the International Court of Justice art. 65, June 26, 1945, 59 Stat. 1031, 33 U.N.T.S. 993.
[75] See e.g. INTERNATIONAL COURT OF JUSTICE. Advisory Opinion Concerning Reservations to the Convention on the Prevention and Punishment of the Crime of Genocide, I.C.J. Rep. 1951 (May 28), p. 15.
[76] KELLY, Michael J., and Luis MORENO-OCAMPO. Introduction. In: Prosecuting Corporations for genocide. Oxford University Press, 2016, pp. 1–14.

Case? It is a question that can be hard to answer; however, the victory here was symbolic, and it presents a ray of hope for the future of criminal liability under international law. This paper discussed possible solutions and how difficult it can be to implement them. Nevertheless, if the companies mentioned in this paper were tried as companies, a greater thirst for justice could have been satisfied.

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# Covid-19 vaccination practices in the workplace and the comparison of data protection practices between the European Union and Turkey

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***Abstract:*** *The world has been dealing with a pandemic for almost two years. Since COVID-19 has been spreading rapidly, individuals have been asked to provide test results about not being infected. Test results and vaccination fall within the scope of personal data. To be more specific, these data are categorized as health data. The safety of health data throughout the pandemic needs to be ensured. There must be certain procedures to follow when people process health data. To secure the workplace, employers ask about the vaccination status of their employees. This paper focuses on the processing of vaccination status of employees in the workplace and whether employers can record the vaccination status of their employees and the terms under which they can do so. In this regard, processing vaccination data in the practices of United Kingdom, Belgium, Ireland, Czech Republic, Italy, and Turkey will be evaluated.*

***Keywords****: COVID-19, vaccination, health data, personal data.*

## INTRODUCTION

Employers who work in private or public sectors, collect data on their employees from the moment the employees apply for jobs. It is common practice to process data of the employees. However, employers must follow some principles to process these data. With the pandemic that has spread all over the world, employers have the need to process health data of their employees in order to secure the workplace since there is a risk of infection. Health data are regarded as a special category of personal data and processing such data must be subject to some strict rules and procedures. The consent of individuals to process their data is one of the lawful bases of processing such data. It can be seen in most legislations that consent is the key to be able to process personal data. However, not all consents provided can be counted as lawful. Consent must consist of three objectives: it must be freely given, it must be given after being informed and it must be specific to an issue. If the three objectives are not present in the consent, then it is unlawful to process data depending on that consent.

A consent of employees is often considered as unlawful because there is the dependency of the employee to the employer. The employer has power over the employee. Therefore, it must be assured that employees, in these situations, are able to give their consent without hesitation. With the pandemic, health data

showing the records of the well-being of employees are requested by the employers, particularly the vaccination status, PCR tests and the codes to show that people are not infected. When employers process health data, they cannot depend on consent since it can easily be jeopardized. Therefore, the data protection authorities all around the world have been given decisions and publishing guidelines to solve this problem. In this paper, decisions and guidelines of the data protection authorities in the European Union and Turkey will be evaluated.

## 1. HEALTH DATA AS THE STATUS OF VACCINATION

### 1.1. Personal Data

The definition of personal data is indicated in the legislation of national states as well as in international treaties.". For many years, experts tried to develop to the most accurate definition. To this day, it is regarded as *any information relating to an identified or identifiable natural person*. This definition is used in the international treaties such as The Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data (CETS No. 108) and Regulation (European Union) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data and repealing Directive 95/46/EC (hereinafter "GPDR") as well. There is no limitation of the definition of personal data. It means that every possible information regarding to a natural person can be considered as personal data. For instance, the European Court of Human Rights has ruled that if a person's voice is identifying that person, it could be considered as personal data.[1]

There are three important main subjects regarding personal data. The data subject is the person whose data are processed. The controller is the person who operates the aim and tools for the processing of personal data. The processor is the person who follows the rules of the controller when processing personal data. In this matter, the data subject must be a natural person. However, controllers and processors may be both natural and legal persons. The important issue is that the information of the legal person is not regarded as personal data so long as it does not identify a natural person.

### 1.2. Health Data

Sensitive data are data that is categorized under certain conditions. In Article 9 of the GDPR, "*racial or ethnic origin, political opinions, religious or*

[1] European Court of Human Rights, *P.G. and J.H. v. United Kingdom,* Application No.: 44787/98, 25 September 2001, para. 59 https://hudoc.echr.coe.int/tur#{%22fulltext%22:[%224478 7/98%22],%22documentcollectionid2%22:[%22GRANDCHAMBER%22,%22CHAMBER%22],%22itemid%22:[%22001-59665%22]} [viewed on 11 October 2021].

*philosophical beliefs, or trade union membership, and the processing of genetic data, biometric data for the purpose of uniquely identifying a natural person, data concerning health or data concerning a natural person's sex life or sexual orientation*" are considered sensitive data. Additionally, personal data about criminal convictions and offences which are regulated under Article 10 of GDPR, should be treated differently as well.[2] They must be processed more cautiously and must have some special protection. Sensitive data can only be processed under limited circumstances.[3]

Personal health data are defined as "*all data pertaining to the health status of a data subject which reveal information relating to the past, current or future physical or mental health status of the data subject*" in the Recital 35 of the GDPR. As a parallel approach to the definition of personal data, the definition of personal health data does not limit the scope of these data. All possible information relating to the health status of a person may be considered as health data. The limitation is in the definition of the health status itself. This means that the data must disclose past, current, or future physical or mental health status of the data subject in order to be considered as health data.

### 1.3. The Status of Vaccination

Information related to COVID-19 amongst individuals should be classified as health data. To that extent, many data protection authorities have begun to publish the importance of processing of such data. For instance, the Turkish Data Protection Authority has announced that information regarding the health status of individuals such as analyses, tests, reports, and vaccination status are considered as health data, and they have to be protected under the Turkish Data Protection Regulation.[4] Additionally, the Information Commissioner's Office (hereinafter "ICO"), the Data Protection Authority of United Kingdom, has defined the COVID-19 status of individuals as a special category data.[5] Thus, there is no doubt that the status of vaccination falls within the scope of health data.

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[2] BHAIMIA, Sahar. *The General Data Protection Regulation: the Next Generation of EU Data Protection*, Legal Information Management, Volume 18, Issue 1, March 2018, pp. 21 – 28, p. 24, https://doi.org/10.1017/S1472669618000051 [viewed on 17 November 2021].

[3] Information Commissioner's Office, Guide to General Data Protection Regulation, https://ico.org.uk/media/for-organisations/guide-to-the-general-data-protection-regulation-gdpr-1-0.pdf, p. 10 [viewed on 11 October 2021].

[4] Turkish Data Protection Board, Decision No. 2021/980, 28 September 2021, https://kvkk.gov.tr/Icerik/7055/COVID-19-PCR-TEST-SONUCU-VE-ASI-BILGISI-UYGULAMALARINA-ILISKIN-KAMUOYU-DUYURUSU [viewed on 11 October 2021].

[5] Information Commissioner's Office, Vaccination and COVID status checks, https://ico.org.uk/global/data-protection-and-coronavirus-information-hub/coronavirus-recovery-data-protection-advice-for-organisations/vaccination-and-covid-status-checks/#canIcheck [viewed on 11 October 2021].

## 2. PROCESSING THE VACCINATION DATA IN THE WORKPLACE

All activities related to data can be considered as processing. Article 4 of the GDPR states processing as "*any operation or set of operations which is performed on personal data or on sets of personal data, whether or not by automated means, such as collection, recording, organisation, structuring, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, restriction, erasure or destruction*". Although some of the activities are counted in the mentioned Article, it does not mean that it is only limited to these activities.

The rule is that personal data are processed with the consent of the individuals. The consent must be freely given, based on given information, and must be concerned on specific issues.[6] As a result of free consent, employees should be able to revoke the consent any time. Due to Article 7 of the GDPR, data subjects have the right to withdraw their consent when they wish to do so. It is important to point out that when consent is withdrawn, it does not have a retroactive effect.[7] That is to say that processing activities before the withdrawal would have a lawful basis.[8] In the relationship between employers and employees, employees do not have the power to give consent freely.[9] Employees could fear that if they do not give consent, they could face unfair treatment.[10] In other words, when there is a status of being dependent, the consent given by free will would be jeopardized.[11] In this context, employers cannot process the personal data of employees based on consent.[12]

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[6] See Article 7 of the GDPR, Article 3 of the Turkish Law No. 6698

[7] POLITOU Eugenia, Efthimios ALEPIPS, and Constantinos PATSAKIS. Forgetting personal data and revoking consent under the GDPR: Challenges and proposed solutions. *Journal of Cybersecurity*, 2018, 4(1), pp. 1-20. https://doi.org/10.1093/cybsec/tyy001.

[8] ÇEKİN, Mesut Serdar. *Avrupa Birliği Hukukuyla Mukayeseli Olarak 6698 Sayılı Kanun Çerçevesinde Kişisel Verilerin Korunması Hukuku*, On Ikı Levha Publishing, Istanbul, July 2020, p. 98, ISBN: 978-625-7899-67-3

[9] European Data Protection Board, Guidelines 05/2020 on consent under Regulation 2016/679, Version 1.1., 4 May 2020, https://edpb.europa.eu/sites/default/files/files/file1/edpb_guidelines_20 2005_consent_en.pdf [viewed on 17 November 2021].

[10] ŠVEC, Marek, and Jan HORECKÝ, Adam MADLEŇÁK. *GDPR in labour relations - with or without the consent of the employee?*, Journal of Interdisciplinary Research, Volume 8, Issue 2, 2018, pp. 281-286, p. 282, http://www.magnanimitas.cz/ADALTA/0802/papers/A_svec.pdf [viewed on 17 November 2021].

[11] UNCULAR, Selen. *İş İlişkisinde İşçinin Kişisel Verilerinin Korunması*, Seckin Publishing, Ankara, October 2018, p. 143, ISBN: 978-975-02-5134-4; OGRISEG, Claudia. *GDPR and Personal Data Protection in the Employment Context*, Labour Law Issues, Vol. 3, No. 2, 2017, ISSN: 2421-2695, p. 11, https://labourlaw.unibo.it/article/view/7573/7276 [viewed on 11 October 2021];

[12] European Commission, Can my employer require me to give my consent to use my personal data?, https://ec.europa.eu/info/law/law-topic/data-protection/reform/rights-citizens/how-my-personal-data-protected/can-my-employer-require-me-give-my-consent-use-my-personal-data_en [viewed on 11 October 2021].

However, there are some exceptions to this rule. Under some conditions, data can be processed without consent. The conditions for doing so are set forth in Article 6 of the GDPR. It states that processing can be lawful if there is consent. Under the conditions below, it is not compulsory for consent to be given.

- *"processing is necessary for the performance of a contract to which the data subject is party or in order to take steps at the request of the data subject prior to entering into a contract,*
- *processing is necessary for compliance with a legal obligation to which the controller is subject,*
- *processing is necessary in order to protect the vital interests of the data subject or of another natural person,*
- *processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in the controller,*
- *processing is necessary for the purposes of the legitimate interests pursued by the controller or by a third party"*

For instance, an employee starts to work and signs the contract of employment. In that contract, there is no need for the consent of the employee to give the account details because for the performance of the contract, to be able to pay the employee, the employer must have the data of their bank accounts.

The same rule applies for sensitive data as well. Sensitive data must be processed with an explicit consent. The rules for not having explicit consent differ between data protection regulation in Turkey and GDPR.

Since the date of the entering into force of GPDR, every subject dealing with personal data have become more careful with the application of GDPR.[13] The authority of the employer to collect health data of employees is one of the most discussed topics in this field. Since the COVID-19 pandemic, employers have been wishing to collect health data of their employees. To be more specific, employers who could not have their employees working from home have started to ask for data showing that employees are not infected. It is the employers' duty to take care of the health in the workplace.[14] Due to occupational health and safety rules, employers must be assured of the fact that there cannot be any infection in the workplace. Therefore, they ask their employees to show evidence of their health status. There are some principles to be followed when there is the processing of personal data. Those principles, which are indicated in the Article 5 of the GDPR, are

- **lawfulness, fairness and transparency,** meaning that personal data

[13] FATEHI, Farhad and Farkhondeh HASSANDOUST, Ryan K.L. KO, Saeed AKHLAGHPOUR. *General Data Protection Regulation (GDPR) in Healthcare: Hot Topics and Research Fronts*, European Federation for Medical Informatics (EFMI) and IOS Press, Volume 270, 2020, pp. 1118 – 1122, p. 1121, https://ebooks.iospress.nl/publication/54338 [viewed on 17.11.2021].

[14] LEWIS, John, and Greta THORNBODY. Em*ployment Law and Occupational Health: A Practical Handbook*, Wiley-Blackwell Publishing, ISBN: 978-1-4051-9783-0.

must be "*processed lawfully, fairly and in a transparent manner in relation to the data subject."*

- **purpose limitation**, meaning that personal data must be "*collected for specified, explicit and legitimate purposes and not further processed in a manner that is incompatible with those purposes."*
- **data minimisation**, meaning that personal data must be *"adequate, relevant and limited to what is necessary in relation to the purposes for which they are processed."*
- **accuracy**, meaning that personal data must be "*accurate and, where necessary, kept up to date."*
- **storage limitation**, meaning that personal data must be *"kept in a form which permits identification of data subjects for no longer than is necessary for the purposes for which the personal data are processed."*
- **integrity and confidentiality**, meaning that personal data must be "*processed in a manner that ensures appropriate security of the personal data, including protection against unauthorised or unlawful processing and against accidental loss, destruction or damage, using appropriate technical or organisational measures"*[15]

ICO states in one of its guidelines that employers must have a clear, necessary, and transparent purpose about the processing of the vaccination status of the employees.[16] All the principles mentioned above must be taken into account.

## 3. COMPARISON OF DATA PROTECTION PRACTICES BETWEEN TURKEY, THE EUROPEAN UNION, AND THE UNITED KINGDOM

### 3.1. Practices in Some European Union Member States and the United Kingdom

Under Article 288 of the Treaty on the Functioning of the European Union, a directive is binding upon each Member State to which it is addressed, and the choice of form and methods of the application is left to Member States. However, a regulation has general application, and it is binding and directly applicable in all Member States.[17] The GDPR entered into force on 25 May 2018 replacing the Data Protection Directive 95/46/EC (hereinafter "the Directive"). This means that the GDPR, as a regulation, is binding entirely on all Member States without implementing any acts. The application of GDPR to data protection rules is broader than the Directive. It has brought innovations in many areas related to the protection of personal data.

Since the pandemic, the same question was asked to the authorities on

[15] The explanations in the quotation marks are taken from the Article 5 of the GDPR.
[16] See *supra* note 5 [viewed on 11 October 2021].
[17] The Treaty on the Functioning of the European Union. Available from: https://eur-lex.europa.eu/eli/treaty/tfeu_2012/oj.

how to process health data of employees. Therefore, some authorities have published guidelines regarding this issue. Even though the United Kingdom is not a member of the European Union as of 31 January 2020, examples and guidelines of the ICO can be counted as very significant in the field of the protection of personal data. Therefore, the guidelines of ICO on the issue of vaccination will be examined. The ICO has clearly stated that it is essential to have a good reason to process the health data of employees.[18] Employers may process personal data of the employees if they do so on a legal basis.[19] Employers must not check the status of COVID-19 under a "just in case" basis.[20] The ICO states that the position of the employee or the work is crucial to decide whether or not the employer can check the vaccination status.[21] If employees work in a place where they are most likely to be infected, it gives a legitimate purpose to the employer to collect vaccination status.[22] Additionally, the ICO has stated that if the processing of such data results in an unfair treatment to employees, it is strictly forbidden to process such data.[23] Moreover, the ICO indicates that being vaccinated is a completely personal decision.[24] Furthermore, the ICO asserts that such data must be stored confidentially, and they must be secured. [25] Finally, controllers should make a data protection impact assessment when processing activities resulting in a high risk to the rights and freedoms of data subjects due to Article 35 of the GDPR. The ICO emphasises the importance of this rule and states that when there is a high level of risk towards employees' rights (such as accessibility to opportunities in the workplace), employers should carry out a data protection impact assessment.[26]

Secondly, the Belgium Data Protection Authority has published that vaccination status of employees can only be processed under Article 9(2) of the GDPR.[27] The mentioned article states the conditions for processing special categories of personal data. Giving explicit consent is one of the conditions stated in the Article 9(2). Explicit consent must be freely given, under a positive action

[18] See *supra* note 5 [viewed on 11 October 2021].
[19] MIHĂILĂ, Carmen Oana, and Mircea MIHĂILĂ. *The Legal Interest, Legal Basis for the Processing of Personal Data and the Right to Private Life*, Fiat Iustitia, No. 1/2020, pp. 127-140, p.131, http://fiatiustitia.ro/wp-content/uploads/2021/05/Fiat_1_2020_134-148.pdf [viewed on 11 October 2021].
[20] See *supra* note 5. [viewed on 11 October 2021].
[21] *Ibid.*
[22] *Ibid.*
[23] *Ibid.*
[24] *Ibid.*
[25] *Ibid.*
[26] See *supra* note 5 [viewed on 11 October 2021].
[27] Belgium: DPA issues FAQs on processing personal data regarding vaccination, https://www.dataguidance.com/news/belgium-dpa-issues-faqs-processing-personal-data [viewed on 11 October 2021].

and it can be withdrawn at any point the data subject wishes to do so.[28] The Belgium Data Protection Authority indicates that if consent is not freely given, it does not constitute a legal basis for processing employees' vaccination status.[29] The Authority additionally indicates that due to the nature of the imbalanced relationship between an employer and employee, consent is rarely given freely.[30] Furthermore, the Authority states that employers cannot even ask occupational physicians in the workplace whether or not employees have been vaccinated on account of the fact that it would jeopardize the security and secrecy of the health data of employees.[31] Moreover, the Authority adds that even if the employer asks an employee about their vaccination status, it is counted as an activity of processing. It can be only possible under certain conditions specified in Article 9(2), i.e., performance of contract.[32]

Thirdly, the Ireland Data Protection Authority has published a guideline on processing COVID-19 vaccination data in the context of employment. It emphasises a very essential condition to process: data minimisation. Employers must decide whether collecting vaccination data is a necessary measure. For instance, employees may work from home if they do not need to be present in the workplace. In addition, the guideline indicates that vaccination on a voluntary basis and vaccine date cannot be necessary or proportionate in the employment context. Similarly to the Belgium Data Protection Authority, Ireland Data Protection Authority indicates the imbalanced nature of the relationship between employer and employee. Thus, processing vaccination data in the context of employment cannot be based on the consent of the employee.[33] The Authority updated its guidelines and in the previous version it said accurately that the long-term effectiveness of vaccination cannot be determined and COVID-19 variants may arise, therefore rendering the vaccination data at hand could be useless.[34]

Fourthly, the Italian Data Protection Authority has published a Frequently Asked Questions document as guidelines for the processing of vaccinations at the workplace. It stated that employers can process personal data of the

[28] Information Commissioner's Office, What are the conditions for processing?, https://ico.org.uk/for-organisations/guide-to-data-protection/guide-to-the-general-data-protection-regulation-gdpr/special-category-data/what-are-the-conditions-for-processing/ [viewed on 11 October 2021].
[29] See *supra* note 27 [viewed on 11 October 2021].
[30] Belgium Data Protection Authority, Traitement de données de vaccination dans le cadre de la lutte contre le Covid-19, https://www.autoriteprotectiondonnees.be/citoyen/themes/covid-19/vaccination [viewed on 11 October 2021].
[31] *Ibid.*
[32] *Ibid.*
[33] Ireland Data Protection Authority, Processing COVID-19 Vaccination Data in the context of Employment and the Work Safely Protocol, https://www.dataprotection.ie/sites/default/files/uploads/2021-11/ [viewed on 4 November 2021].
[34] Ireland Data Protection Authority, Processing COVID-19 Vaccination Data in the context of Employment, https://www.dataprotection.ie/sites/default/files/uploads/2021-06/Processing%20COVID-19%20Vaccination%20Data%20in%20the%20context%20of%20Employment_0.pdf [viewed on 11 October 2021].

employees if employees themselves provide the information, if it is necessary to collaborate with public health authorities for the purpose of safety in the workplace and if the employees who tested positive for COVID-19 would need to come back to the workplace.[35]

Lastly, the Czech Data Protection Authority has released a statement regarding the mandatory testing of employees, which is a measure taken by the Ministry of Health. The Authority indicates the imbalanced employer-employee relationship and emphasises the treatment of the personal data of employees whilst respecting their privacy and human dignity. It states that if the testing is operated by a health service provider as a medical service, there must be a contractual relationship between the employer and the health care provider. If the testing is not operated by a health service provider but an employer itself, then the employer is bound to follow the liabilities of a controller and the employer may do so only while meeting the requirements imposed by the emergency measure. The Authority indicates that the employer as a controller, must follow the obligations, particularly to inform data subjects, to keep records in accordance with the GDPR for a necessary period and to ensure that data is secured by taking technical and organizational measures.[36] Similarly to the Turkish practice, which will be detailed below, the Ministry of Labour and Social Affairs of the Czech Republic has stated that employees must inform their employers whether they carry possible risks of COVID-19. Therefore, employers are given authority to process the health data of their employees, but they must follow the rules of GDPR.[37]

It should not be forgotten that every EU Member State has its own national legislation regarding the context of employment and that legislation could differ from one State to another. However, the rules of the GDPR are the same for every Member State and the principles for processing must be followed in each processing activity. For instance, in the Statement of European Data Protection Board which works as an independent European body to regulate the application of the GDPR, it is stated that employers could process health data of employees so long as the national laws allow them as a processing activity based on legal obligations.[38] In this scope, when employers process the personal data of

[35] Italian Data Protection Authority, Coronavirus: Information from the Italian Supervisory Authority, https://www.garanteprivacy.it/web/garante-privacy-en/coronavirus-information-from-the-italian-supervisory-authority#FAQ [viewed on 11 October 2021].

[36] Czech Data Protection Authority, K povinnému testování zaměstnanců – rozšířené vyjádření, https://www.uoou.cz/k-povinnemu-testovani-zamestnancu-rozsirene-vyjadreni/d-48835 [viewed on 11 October 2021].

[37] COVID-19 and Data Protection Compliance in the Czech Republic, https://www.whitecase.com/publications/alert/covid-19-and-data-protection-compliance-czech-republic [viewed on 11 October 2021].

[38] European Data Protection Board, Statement on the processing of personal data in the context of the COVID-19 outbreak, 19 March 2020, https://edpb.europa.eu/sites/default/files/files/file1/edpb_statement_2020_processingpersonaldataandcovid-19_en.pdf [viewed on 17 November 2021].

employees, they have to take into account both GDPR and national legislation regarding the context of employment.

### 3.2. Practices in Turkey

Article 6(3) of the Turkish Personal Data Protection Law No. 6698 (hereinafter "Turkish Law No. 6698") states that health data cannot be processed without explicit consent if there is an issue of public health, performing preventive medicine, medical diagnosis, treatment, and care services, planning, and managing health services and their financing and if it is processed by authorized institutions and organizations who are under obligation to keep secrets. Thus, it can be said that employers may process these data without explicit consent, but it must be processed by authorized institutions and organizations who are under the obligation to keep secrets such as an occupational physician. Therefore, Article 6(3) indicates the exceptions to process health data without the explicit consent of the data subjects. There is a similar regulation in the GDPR, Article 9(2). It states that processing of special categories of personal data is possible if "*processing is necessary for the purposes of preventive or occupational medicine, for the assessment of the working capacity of the employee, medical diagnosis, the provision of health or social care or treatment or the management of health or social care systems and services on the basis of Union or Member State law or pursuant to contract with a health professional and subject to the conditions and safeguards referred to in paragraph 3*". As can be seen in the article, GDPR puts more accurate solution to processing health data. If processing is necessary for preventive medicine, or for occupational medicine, the health data can be processed *"when such data are processed by or under the responsibility of a professional subject to the obligation of professional secrecy under Union or Member State law or rules established by national competent bodies or by another person also subject to an obligation of secrecy under Union or Member State law or rules established by national competent bodies*"[39] under Article 9(3) GDPR. In addition to this, Article 9(4) GDPR states that Member States may put further conditions, including limitations in processing health data. Therefore, by way of national laws, Member States can introduce more limitations.

In Turkish legislation, there are a few sources that allow employers to collect some of health data of employees under occupational safety measures. It should not be forgotten that Turkish Law No. 6698 must be applied in these processing activities. From the beginning of the pandemic, Turkish Data Protection Authority have been making announcements on how to process data in times of pandemic. Some announcements are about the processing activities in the context of employment. For instance, in one of the announcements it is stated that the situation of working from home does not change the strict rule to follow the rules

[39] Article 9(3) of the GDPR.

of Turkish Law No. 6698.[40] When employees work from home, all necessary technical and administrative measures to protect safety of data must be taken.[41] To give another example, in the announcement it is stated that if an employee is tested positive, employers should inform the employees about these incidents, but it is not necessary to provide the names (or more information) of that employee.[42] If it is obligatory to disclose such information in order to take protective measures, then the employee must be informed beforehand.[43] To protect the employee who tested positive from any discrimination and to protect dignity of the employee, the personal data must not be revealed.[44]

On 3 September 2021, the Turkish Ministry of Labour and Social Security stated that in order to cover the risks of health and security, employers may require PCR tests from employees, who are not vaccinated, once a week and the results of those test would be recorded in order to take necessary actions.[45] Therefore, employers have begun to ask about the PCR tests and vaccination status of employees. It should not be forgotten that even if there is no similar statement to allow employers to do so, they must follow the rules of Turkish Law no. 6698 when they process such data. For some time, it was not clear if employers should take these data with or without consent. Thus, the Turkish Data Protection Board has reached a decision[46] that in order to prevent the pandemic from becoming more contagious, processing activities of the public institutions and organizations authorized by law is within the scope of Article 28 of Law No. 6998 which indicates that to ensure national defence, national security, public safety, public order or economic security, processing activities within the scope of preventive, protective and intelligence activities carried out by public institutions and organizations authorized by law are exempt from the Law No. 6698. Therefore, it can be said that processing PCR results and vaccination status by public institutions and organizations authorized by law is not subject to the consent of the data subject. Therefore, it could be said that when public institutions and organizations authorized by law allow employers to process the vaccination data of the employees,

[40] Turkish Data Protection Board, Things to Know Under the Law on the Protection of Personal Data in Combatting Covid-19, 27 March 2020, https://www.kvkk.gov.tr/Icerik/6721/KAMUOYU-DUYURUSU-Covid-19-ile-Mucadele-Surecinde-Kisisel-Verilerin-Korunmasi-Kanunu-Kapsaminda-Bilinmesi-Gerekenler- [viewed on 17 November 2021].

[41] *Ibid.*

[42] *Ibid.*

[43] *Ibid.*

[44] SUDER, Seili. *Processing employees' personal data during the Covid-19 pandemic,* European Labour Law Journal, Vol. 12(3), 2021, pp. 322-337, p. 336, https://journals.sagepub.com/doi/pdf/10.1177/2031952520978994 [viewed on 17 November 2021]; SHABANI Mahsa, and Tom GOFFIN, Heidi MERTES. *Reporting, recording, and communication of COVID-19 cases in workplace: data protection as a moving target,* Journal of Law and the Biosciences, Volume 7, Issue 1, January-June 2020, pp. 1-5, p. 2, https://doi.org/10.1093/jlb/lsaa008, [viewed on 17 November 2021].

[45] Turkish Ministry of Labour and Social Security Covid-19 Measures in the Workplace, https://www.csgb.gov.tr/duyurular/is-yerlerinde-covid-19-tedbirleri/ [viewed on 17 November 2021].

[46] See supra note 4. [viewed on 11 October 2021].

employers may process the data without any other conditions.

## CONCLUSION

The Turkish Law No. 6698 entered into force on 7 April 2016 and was prepared based on the European Union Directive. GDPR entered into force on 25 May 2018 and under its Article 94 (1) it repealed the Directive. Therefore, GDPR has more specific and updated provisions. However, the main purpose of both of the sources of legislation is the same. Based on evaluating both legislations, it can be said that vaccination status or results of PCR tests are regarded as health data, which is a special category of personal data, and health data must be processed under strict and limited conditions. As can be seen from all of the practices of the data protection authorities, health data can be processed with the consent of the data subject, in this context, with the consent of the employee. However, the nature of the relationship between the employer and employee is imbalanced. The employer has more power over the employee. Moreover, one of the three main principles of the consent is that it should be given freely. Therefore, employees, in general, cannot give their consent freely in the context of employment. It can be said that it is not logical to collect health data of employees by relying on their consent. Since depending on consent of employees may be unreliable in processing their data, data protection authorities published guidelines under which employers can process that data of their employees. In this context, the processing activities can be done under very strict circumstances.

Furthermore, it must not be forgotten that each processing activity should be based on giving information to the data subjects first. After the data subject understands the scope of processing, processing activities can begin.

It is compulsory to obey the rules on national legislation as well. However, when it comes to the issues of personal data protection, the rules specific to this area must additionally be followed. Therefore, in the European Union, business activities regarding personal data protection must be carried out by following the rules of GDPR.

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# SECTION V
# IT LAW

# The future of net neutrality and zero rating in the EU after recent decisions

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***Abstract:*** *On 30 April 2016, entered into force Regulation (EU) 2015/2120 (also known as Open Internet Regulation), laying down the foundation for net neutrality rules in the EU and creating an ex-ante regulation for the telecommunication services market, ensuring no discrimination for the users of the internet based upon the type of traffic. The regulation put the weight of the balancing act on NRAs (national regulatory authorities) and subsequently courts.*
*The author aims to comment on the significant rulings since the adoption of the regulation, mainly focusing on recent rulings from September 2020 and September 2021 of the CJEU to analyse the development the net neutrality underwent in mere five years since the adoption of Open Internet Regulation and where the regulation might head next after those rulings.*

***Keywords:*** *Net Neutrality, EU, Regulation, Zero-Rating.*

## INTRODUCTION

Network (or simply Net) neutrality is a principle of equal treatment (non-discrimination) of content transferred by the ISPs (Internet Service Providers). In its purest meaning, it reduces the ISPs to mere "plumbers" of network cables and devices who make sure the flow of data traffic is smooth.[1] On the other side of the spectrum is a principle of network prioritisation, which not only allows but even encourages ISPs to issue different priorities to different content and monetise these practices. Net neutrality is often used as a general name for the topic of discussions of how much freedom should ISPs have in managing network traffic. For the purpose of this paper, in order to analyse the regulation and its possible changes, the author will refer to this scale: *network prioritisation – soft net neutrality – hard net neutrality*.[2] The network prioritisation and "hard" net neutrality

[1] See CHENG, Hsing Kenneth, Subhajyoti BANDYOPADHYAY, and Hong GUO. The Debate on Net Neutrality: A Policy Perspective. *Information Systems Research* [online]. 2011, **22**(1), 60–82. ISSN 1526-5536 [viewed 7 November 2021]. Available from: doi:10.1287/isre.1090.0257.
[2] A similar distinction is made by other authors such as ANDRIYCHUK, Oles. (Why) Did EU Net Neutrality Rules Overshoot the Mark? Internet, Disruptive Innovation and EU Competition Law & Policy. *Yearbook of Antitrust and Regulatory Studies*. 2018, **11**(18), 227–239. ISSN 2545-0115. Available from: doi:10.7172/1689-9024.yars.2018.11.18.9 or GANS, Joshua S.Weak versus strong

were explained above. With the "soft" net neutrality rules, the author means a regulation, where ISPs are generally obliged to not discriminate. However, they are allowed a degree of deviance and prioritize some types of traffic and even monetize these practices, all predicted by the regulator. This is what net neutrality in practice looks like (or should[3]), although the level of freedom can vary greatly by the view of the individual on the "softness" of the regulation.[4]

In this paper the author will focus on net neutrality regulation in the EU. The main regulatory instrument in this area is Regulation (EU) 2015/2120 of the European Parliament and of the Council of 25 November 2015 laying down measures concerning open internet access and amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services and Regulation (EU) No 531/2012 on roaming on public mobile communications networks within the Union, simply known as the *Open Internet Regulation*. The author will analyse the abovementioned regulation and the main rulings stemming from it. From the analysis of the development of the zero-rating practice, the author will demonstrate how the process of the net neutrality regulation in the EU as a whole is not ideal for the subjects (ISPs[5]).

## 1. THE REGULATION WITH A HEART OF DIRECTIVE

The Open Internet Regulation entered into force on 30 April 2016 and was a result of a long adoption process that started in 2006 with the review of current regulatory framework.[6] A long debate about the state and future of net neutrality in the EU ensued.[7] Citizens, lobbyists, and regulators[8] debated for years

net neutrality. *Journal of Regulatory Economics* [online]. 2014, **47**(2), 183–200. ISSN 1573-0468 [viewed 7 November 2021]. Available from: doi:10.1007/s11149-014-9266-7.

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[4] See e.g. MA, Richard T. B., Jingjing WANG, and Dah Ming CHIU. Paid Prioritization and Its Impact on Net Neutrality. *IEEE Journal on Selected Areas in Communications* [online]. 2017, **35**(2), 367–379. ISSN 1558-0008 [viewed 7 November 2021]. Available from: doi:10.1109/jsac.2017.2659020.

[5] The main subjected party of this regulation are internet service providers, usually the operators of mobile phone and internet services such as Vodafone, T-Mobile, Deutsche Telekom, etc. In the literature, both internet access providers (IAPs) and internet service providers (ISPs) are used. In this paper, the author will use a general umbrella term of ISP, though the term IAP or operator might be more fitting.

[6] Communication from the Commission of 29 June 2006 on the review of the EU Regulatory Framework for electronic communications networks and services COM(2006) 334 final [online]. In EUR-Lex Available from: https://eur-lex.europa.eu/legal-content/CS/ALL/?uri=CELEX:52006SC0817

[7] MANIADAKI, Katerina. Net Neutrality Regulation in the EU: Competition and Beyond. *Journal of European Competition Law & Practice*. 2019. ISSN 2041-7772. Available from: doi:10.1093/jeclap/lpz049. pp.482-484.

[8] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - The Open Internet and Net

over the nature and state of current framework[9] and its safeguards for citizens' rights. The main player in this debate then and now has been the BEREC (Body of European Regulators for Electronic Communications). It was upon its investigation results of traffic management practices from 29 May 2012[10] and its findings on differentiation practices and competition issues from 12 November 2012[11], that the EU Commission acted and proposed a new regulation.[12]

However, the rules imposed by the regulation do not work "as-is ", which is rather typical for an EU regulation (unlike directives, where necessary work by state legislators is presumed). The Article 5 of the Open Internet Regulation, titled *Supervision and enforcement*, not only sets out the powers for national regulatory authorities (NRAs)[13], but also admits that additional guidelines (provided by BEREC after consulting stakeholders and Commission) for implementation of this regulation are needed.[14] These guidelines are to be reviewed and updated to reflect the technology and infrastructure evolution.[15] The BEREC already reviewed the guidelines in 2020[16] and has published periodic monitoring reports annually since 2017. Although these guidelines are aimed at providing consistency[17] by having recommending effect on NRAs (although not legally binding), it is hard to say, whether it really does fulfil this job. This doubt comes especially from the statement by the BEREC made on 7 September 2021, where after recent rulings by the Court of Justice of the EU (CJEU) (which are subject of this article) the BEREC already coined that they will review the guidelines again in the light of

Neutrality in Europe COM (2011) 222 final [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0222:FIN:EN:PDF.

[9] Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32002L0022.

[10] BEREC findings on traffic management practices in Europe. BoR (12) 30 [online]. Available from: https://berec.europa.eu/eng/document_register/subject_matter/berec/reports/45-berec-findings-on-traffic-management-practices-in-europe.

[11] BEREC report on differentiation practices and related competition issues in the scope of net neutrality. BoR (12) 132 [online]. In EUR-Lex. Available from: https://berec.europa.eu/eng/document_register/subject_matter/berec/reports/1094-berec-report-on-differentiation-practices-and-related-competition-issues-in-the-scope-of-net-neutrality.

[12] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Telecommunications Single Market COM (2013) 634 final [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0634:FIN:EN:PDF.

[13] Ibid. Art.5 (1) and (2).

[14] Ibid. Art. 5 (3).

[15] Ibid. Recital (18).

[16] See BEREC Guidelines on the Implementation of the Open Internet Regulation BoR 20 (112) [online]. In EUR-Lex. Available from: https://berec.europa.eu/eng/document_register/subject_matter/berec/regulatory_best_practices/guidelines/9277-berec-guidelines-on-the-implementation-of-the-open-internet-regulation.

[17] Ibid. p.2.

these court findings.[18] The question is, how big the change will be and what does it mean for legal certainty of the ISPs.

## 2. RECENT FINDINGS THAT SHAPED THE ZERO-RATING REGULATION AND REDEFINED THE BEREC GUIDELINES

### 2.1. ČTÚ/Vodafone, PTS/Telia and ACM/T-Mobile findings

The Czech Telecommunication Office (ČTÚ) in its monitoring report from 30 April 2017 to 1 May 2018 mentions that zero-rating and other specialized data package offerings were offered in the Czech Republic.[19] It launched several inspections and initiated two administrative proceedings.[20] Particularly interesting is the Vodafone Pass service that was investigated on two counts. First the ČTÚ concluded the infringement of Article 3 paragraph 3 of the Regulation for the zero-rated music streaming service Spotify and ordered the provider to comply with the Regulation (EU) 2015/2120.[21] The service provider allowed single music streaming service to be used even after data cap was reached and other services were not accessible. The second count was related to the same service offered but considered the data traffic management issues of Article 3 of the Regulation. The ČTÚ dealt with two streaming services ("Vodafone Pass" and "StreamOn") where providers reserved the right to introduce data traffic management measures to restrict the quality of the video included in the zero-rating or to reduce its transmission speed.[22] As these measures were not applied to subscriber's standard data volume, there would be a hypothetical breach of Article 3 (3) of the Regulation and the ČTÚ urged providers to change their contract terms.[23] From the wording we can guess that the problem was not in fact a single application (streaming service Spotify), but the mere fact that other traffic was treated differently, however it is still a mere guess as in these cases the practice was clearly discriminatory against other competing services.

A similar reasoning can be found in Swedish Post and Telecom Authority

[18] See BEREC assesses the impact of the recent Court of Justice of the EU judgements on the Open Internet Regulation. *BEREC* [online]. [7 September 2021] [viewed 2 October 2021]. Available from: https://berec.europa.eu/eng/news_and_publications/whats_new/8506-berec-assesses-the-impact-of-the-recent-court-of-justice-of-the-eu-judgements-on-the-open-internet-regulation.

[19] CTU Report on the results of monitoring implementation of Regulation (EU) 2015 for the period from May 1 2017 to April 30 2018. Czech Telecommunication Office. [online]. [viewed 2 October 2021]. Available from: https://www.ctu.eu/sites/default/files/obsah/stranky/227071/soubory/zpravann2018enfinal.pdf.

[20] Ibid. p.8.

[21] Ibid.

[22] Ibid.

[23] Ibid.

(PTS) in their conclusion of the Open Internet Regulation breach by Telia.[24] The two offers in question, the "Free Surf on Social Media" and "Free Surf Listen", allowed users to access social media or streaming services even when their data cap was reached. The PTS ruled that such practice is a discrimination based upon commercial consideration and therefore is in violation of Article 3 (3) of the Regulation.[25]

What these findings have in common, and which can also be observed in other findings and rulings, is that NRAs (and courts) have created a line (or equals sign) between the zero-rating commercial practice and the discrimination of transferred data prohibited by Article 3 par. (3) of the Regulation, which the author thinks a) is too generalizing shortcut and b) was not intended by the legislator in the first place. The Vodafone case is clearer in this sense as it considered a single streaming service (Spotify) which is a situation that the guidelines explicitly state as unlawful.[26] The PTS, however, went further and (what the author thinks is) above the guidelines. This is clear when you consider that PTS ruled no breach of Article 3 (2) of the Regulation in the abovementioned case.[27]

A completely different finding was made by the Dutch Authority for Consumers & Markets (ACM).[28] Under the Dutch law, the zero-rating practice is prohibited.[29] However, in the April 2017 a court ruled this law at odds with the Open Internet Regulation and opened a way for more open investigation by the Dutch NRA. The ACM found out that because the "Data-free Music" does not limit the users' choice (the zero-rating applies to all music streaming apps) it is not in violation of the Regulation.[30] This confirms that even after applying the same rules (the Open Internet Regulation), different NRAs can reach drastically different conclusions. All of these three findings are considered (or consider themselves) to be in compliance both with the Regulation and the BEREC guidelines.

[24] Net Neutrality Report 2016/2017. PTS. [online]. [viewed 1 October 2021]. Available from: https://www.pts.se/globalassets/startpage/dokument/icke-legala-dokument/rapporter/2017/internet/report-eu-net-regulation-pts-er-2017-15.pdf.
[25] Ibid. p.12.
[26] See BEREC Guidelines on the Implementation of the Open Internet Regulation BoR 20 (112) [online]. In EUR-Lex. Available from: https://berec.europa.eu/eng/document_register/subject_matter/berec/regulatory_best_practices/guidelines/9277-berec-guidelines-on-the-implementation-of-the-open-internet-regulation par.42a.
[27] See Net Neutrality Report 2018/2019. PTS. [online]. [viewed 1 October 2021]. Available from: https://www.pts.se/contentassets/e96f52767faa4a3199b94a7725423f19/net-neutrality-report-2018-2019-pts-er-2019-15.pdf p.11.
[28] See T-Mobile can continue to offer its Data-free Music service. *Autoriteit Consument & Markt* [online]. 11 October 2017 [viewed 4 October 2021]. Available from: https://www.acm.nl/en/publications/t-mobile-can-continue-offer-its-data-free-music-service.
[29] Ibid.
[30] Ibid.

### 2.2. Hungarian NNMH vs. Telenor case

The case of Hungarian NRA Nemzeti Média- és Hírközlési Hatóság Elnöke (NNMH) vs. the Telenor provider is a one that no author can omit. It does not offer drastically new viewpoints on the matter than the other NRAs findings mentioned above, however it is the first case of zero-rating and neutrality violation of the Open Internet Regulation that was reviewed by the CJEU.

The Telenor Hungary offered to its customers "My Chat" and "My Music" packages, which were, similar to those abovementioned, zero-rated offerings where the chosen applications (Facebook, Facebook Messenger, Instagram, Twitter, Viber and Whatsapp for "My Chat "and Apple Music, Deezer, Spotify, and Tidal for "My Music ") did not count towards the user's data limit.[31] After Hungarian NRA initialized two procedures and in both found a violation of Article 3 (3) of the Open Internet Regulation as it deemed such practices discriminatory.[32] Those decisions after an administrative procedure initiated by Telenor were brought to Hungarian Court in Budapest. The court then stayed the proceedings and referred the two cases to the CJEU.[33]

The CJEU ruled that such practices[34] *are incompatible with Article 3(2) of Regulation 2015/2120, read in conjunction with Article 3(1) of that regulation, where those packages, agreements, and measures blocking or slowing down traffic limit the exercise of end users' rights, and are incompatible with Article 3(3) of that regulation where those measures blocking or slowing down traffic are based on commercial considerations*.[35] The court considered the most problematic aspect of zero-rating not the practice itself, but mainly the slowing of data after the data cap has been used by the end user, which does not occur for the data covered by the zero-rated offerings. This ruling was expected and understandable, as it provided some (although not very realistic when you consider the practical possibilities) wiggle room for ISP to use similar practices. However, the court went much further in its recent judgements from 2 September 2021.

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[31] Judgment of the Court of Justice of 15 September 2020. Telenor Magyarország Zrt. v. Nemzeti Média- és Hírközlési Hatóság Elnöke. Case C-807/18 [online]. In EUR-Lex. [viewed 4 October 2021]. Available from: https://curia.europa.eu/juris/liste.jsf?num=C-807/18 par. 10. and 11.

[32] Ibid. par. 12.

[33] Ibid. par 14-20.

[34] Ibid.par. 55: *[…]packages made available by a provider of internet access services through agreements concluded with end users, and under which (i) end users may purchase a tariff entitling them to use a specific volume of data without restriction, without any deduction being made from that data volume for using certain specific applications and services covered by 'a zero tariff' and (ii) once that data volume has been used up, those end users may continue to use those specific applications and services without restriction, while measures blocking or slowing down traffic are applied to the other applications and services available[…]*

[35] Ibid.

### 2.3. The three bombs to end the zero-rating

On 2 September 2021 the CJEU issued three identical judgements (C-34/20[36], C-5/20[37] and C-824/19). In all these judgements the main point of legal problem were again zero-rated offerings. There is no need for lengthy explanations of the background and the nature of the offerings in subject, as the CJEU's judgments and the answer were all very short: "zero-tariff" (zero-rating) is incompatible with the EU law, mainly with the Article 3 (3) of Open Internet Regulation, as it is based on a commercial consideration and contrary to the principle of equal treatment of traffic.[38] In its judgements the court also restated (as already ruled in the C-807/18) that not meeting the requirements of Article 3 (3) of the Regulation automatically fails obligations from Article 3 (2) and thus no case-by-case assessments by NRAs (as provided by BEREC Guidelines) is necessary.[39] This ended the years-long debate, whether and under which conditions the zero-rating practice is allowed by the EU law. From the point of the author´s analysis, this now clearly puts the Open Internet Regulation into a hard net neutrality regulation category.

## CONCLUSION

The net neutrality in the EU underwent an interesting development during the last few months and years, mainly thanks to the decisions cited in this article. In the author´s opinion, the EU net neutrality regulation is right now at a monumental crossroad, where the next statement or guidelines from BEREC might shift the debate on the either side or regress the debate back to 2000's and 2010's. The BEREC already reacted to the major ruling by announcing the revision to their Guidelines.[40] The call for guidelines revision to reflect the CJEU's

[36] Judgment of the Court of Justice of 2 September 2021. Telekom Deutschland GmbH v Bundesrepublik Deutschland. Case C-34/20 [online]. In EUR-Lex. [viewed 4 October 2021]. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62020CJ0034.

[37] Judgment of the Court of Justice of 2 September 2021. Bundesverband der Verbraucherzentralen und Verbraucherverbände - Verbraucherzentrale Bundesverband e.V. v Vodafone GmbH. Case C-5/20 [online]. In EUR-Lex. [viewed 4 October 2021]. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62020CJ0005.

[38] See PRESS RELEASE No 145/21. Court of Justice of the European Union. [online]. 2 September 2021. [viewed 3 October 2021]. Available from: https://curia.europa.eu/jcms/upload/docs/application/pdf/2021-09/cp210145en.pdf.

[39] See Judgment of the Court of Justice of 2 September 2021. Telekom Deutschland GmbH v Bundesrepublik Deutschland. Case C-34/20 [online]. In EUR-Lex. [viewed 4 October 2021]. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62020CJ0034 par. 25-26 and 32. (similar or identical reasonings are in all three cases).

[40] See Press release - BEREC will update Guidelines following the Court of Justice rulings on zero-rating, publishes recently adopted reports and calls for stakeholder's input. BEREC [online]. 6 Oc-

effective ban of zero-rating and to strengthen the position of *hard* net neutrality regulation going forward and thus abandoning the former guidelines to make room for more strict interpretation of Art. 3 (3) of the Open Internet Regulation is a logical choice. However, this also brings a public consultation process into the picture which could be viewed as the "Pandora's box" to open the process of long negotiations and debates with stakeholders and lobbyists again. It might not take another ten years, as it did for the process of creating the Regulation, however the March and June 2022 deadlines might be too optimistic.

The zero-rating practices that are currently the main source of conflict with the Regulation might have been a problem that the market would deal with on its own, simply because of no need for such practices as the data caps are increasingly larger and more unlimited data packages are introduced by the providers in the EU.[41] However, the process of dealing with this singular issue might be a symptom of a more severe issue that sits at the core of the Open Internet Regulation as it is now: the "trial and error" process required for ISPs to comply their new services with the regulation might be well beyond the ordinary process of clearing up the law by the courts and authorities that almost all regulations went through. It may put ISPs in the EU (and the EU and its market as a result) in a competitive disadvantage as the costs of introducing a new type of service without the certainty of its compliance with the Regulation might simply be too high.

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# Third-party dispute settlement in online content moderation: a necessary compliance requirement for online platforms or a constitutional aberration?

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***Abstract:*** *Online platforms regulate and remove large amounts of illegal and harmful content (from content infringing IP rights to Covid-19 disinformation). Art. 18 of the proposed EU Digital Services Act Regulation ("DSA"), the most significant piece of regulation concerning online platforms, proposes a new system of "online courts" that would resolve any content-related disputes between platforms and their users. The paper discusses Art. 18 DSA (more precisely its version proposed by the European Commission, which is currently in the legislative process), the requirements it will place on dispute settlement bodies and the possible impact of these requirements on their operation and accessibility of such proceedings to users. It also briefly analyses the position of online platforms as defendants in content-related disputes and suggests changes to Art. 18 DSA that could be made to remove the identified shortcomings.*

***Keywords:*** *Online platforms, Compliance, Digital Services Act, Online Courts, Content Moderation, Dispute Settlement.*

## INTRODUCTION

Recent years have only highlighted the necessity for online platforms and regulators to take more seriously the spread of illegal or otherwise harmful content on the Internet.[1] Online platforms are functioning as "new governors" with increasing control over the spread of information.[2] Various rules to tackle unwanted content online have also been introduced on EU level (e.g. the *right to be forgotten*[3] or the revised EU copyright rulebook) and in EU Member States (e.g.

[1] Participation in the conference and the preparation of this Article was supported by the Charles University Grant Agency ("GAUK") project no. 650120 "Regulation of harmful content in the EU".

[2] KLONICK, Kate. The new governors: The people, rules, and processes governing online speech. *Harvard Law Review*. 2017, 131, pp. 1662-1663.

[3] See Art. 17 of Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data and repealing Directive 95/46/EC [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/eli/reg/2016/679/oj.

the German NetzDG[4]). In late 2020, European Commission proposed an ambitious[5] set of rules governing illegal and harmful content online in the form of the Digital Services Act Regulation ("DSA"), which is currently in the EU legislative process.[6]

This paper aims to analyse Art. 18 DSA, which is bound to create a new system of third-party dispute resolution for disputes between online platforms and their users. The paper firstly describes the *proposed* rules and then analyses Art. 18 DSA from two points of view.

It aims to a) identify shortcomings in the current version of Art. 18 DSA that could, when put into practice, place an undue burden on dispute settlement bodies ("DSB" or "DSBs") or restrict the availability of such proceedings to all users within the EU and b) to concisely review Art. 18 DSA from the position of platforms, and their rights in such proceedings.

Where possible (mainly in Chapter 2) the paper suggests clarifications and amendments that could be made to Art. 18 DSA. In Chapter 3, it also aims to emphasise possible legal repercussions if DSA remains unchanged.

## 1. THIRD-PARTY DISPUTE SETTLEMENT UNDER ART. 18 DSA

The DSA aims to cover all decisions made by platforms concerning content ("information" in DSA's terms[7]) posted or uploaded online on the platform, which is contrary to law (illegal content) or which is not legally prohibited but is contrary to a platform's terms and conditions (harmful content).[8]

DSA distinguishes between several tiers of service providers.[9] Art. 18 DSA applies only to the two highest tiers: *online platforms* (providers of a hosting service which, at the request of a user, stores and disseminates information to the public[10]) and *very large online platforms* (platforms with at least 45 million average monthly active users[11]). The proposal also includes an "SME" exemption

[4] See HELDT, Amélie Pia. Reading between the lines and the numbers: an analysis of the first NetzDG reports. Internet Policy Review [online]. 2019, 8 (2) [viewed 2 October 2021]. Available from: https://policyreview.info/articles/analysis/reading-between-lines-and-numbers-analysis-first-netzdg-reports.

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[7] Art. 2 (g) DSA.

[8] Art. 12 DSA.

[9] Compare Art. 5 DSA, and Chapter III, Sections 1 and 2 DSA.

[10] Art. 2 (h) DSA.

[11] Art. 25 (1) DSA.

from Art. 18 DSA.[12] Art. 18 DSA is thus not limited to the largest online platforms (e.g. Facebook or Twitter), but potentially applies to any sufficiently large platform anywhere within the EU.

According to DSA's preamble, Art. 18 was drafted with the intention to provide users with a chance to easily and effectively contest decisions of online platforms that negatively affect them. At the same time, this system is seen as complementing, not competing with the possibility for users to seek judicial redress in EU Member States.[13]

All dispute decisions covered by DSA must go through two "instances": *internal* (intra-platform) mechanisms, required by Art. 17 DSA, and outside dispute settlement systems required by Art. 18 DSA. These articles cover any content-related decisions: to remove or disable access to content, suspend the provision of the service to some users or suspend an account.[14]

Under Art. 18 DSA, users may challenge platforms' decisions before any *certified* dispute settlement body (or put forward disputes that could not be settled within the platform). Online platforms must a) *engage in good faith* with the DSB to resolve the dispute and b) shall be *bound by the decision* taken by DSBs.[15]

## 2. REQUIREMENTS FOR DISPUTE SETTLEMENT BODIES

All DSBs will have to be certified by Member States' "Digital Service Coordinators" (whose nature is yet to be clarified in DSA's text) after *demonstrating* that they meet DSA's conditions. While some requirements seem unproblematic, others, when put into practice, could present difficulties.

Art. 18 DSA firstly requires that these dispute settlement bodies are impartial and independent of *both* online platforms and the users.[16] This, alongside other requirements, largely disqualifies (in their current form) bodies such as the Facebook Oversight Board. The Oversight Board is a body of selected experts who decide disputes regarding online content and access to Facebook's services. However, under its Charter, it deals with cases selected by Facebook, not *all* user appeals.[17] Furthermore, it is funded by the platform itself (as are other existing

[12] See Annex I, Art. 2 (2) and (3) of Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (notified under document number C(2003) 1422) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32003H0361.
[13] Recital 44 DSA.
[14] See further Art. 17 (1) DSA.
[15] Art. 18 (1) DSA.
[16] Art. 18 (2) a) DSA.
[17] For more on the Board, see KLONICK, Kate. The Facebook Oversight Board: Creating an Independent Institution to Adjudicate Online Free Expression. *Yale Law Review*. 2020, 129 (8), pp. 2470-2471.

bodies dealing with content-related decisions[18]) and the platform either chose or co-selected the first members of this body.[19] While this is not an insurmountable task, Art. 18 DSA will require the establishment of new DSBs, without financial or organizational dependence on platforms.

Two further requirements present seemingly few problems: accessibility through electronic means and clear and fair rules of procedure.[20]

On the other hand, Art. 18 DSA also requires that DSBs demonstrate *necessary expertise* allowing them to settle content-related disputes. As already mentioned, the scope of DSA is not limited to a particular *type* of illegal or harmful content. The expertise must thus concern *one or more types* of illegal content or the application of the terms and conditions of *one or more* particular platforms.[21]

Art. 12 DSA imposes upon platforms the duty to include *any* content-related restrictions in their terms and conditions and apply *all* these rules in a *"diligent, objective and proportionate"* manner. Platforms thus must effectively balance the interests (even those related to public policy) and (fundamental) rights of all parties.[22] However, platforms are constantly introducing new rules and policies, e.g. on disinformation concerning the Covid-19 pandemic[23] or the spread of "hacked" materials in electoral campaigns.[24]

DSBs will also have to respond to changes in enforcement of these rules by platforms: e.g. again during the Covid-19 pandemic, platforms have shifted from carefully balancing conflicting interests in individual cases to fulfilling what is essentially a public health function, even at the cost of making *some* incorrect content-related decisions.[25]

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[18] HOLZNAGEL, Daniel. The Digital Services Act wants you to "sue" Facebook over content decisions in private de facto courts. *Verfassungsblog*. [online]. 2021. [viewed 2 October 2021]. Available from: https://verfassungsblog.de/dsa-art-18/.

[19] Compare Arts. 5 (for funding) and 8 (for selection of members) of: Facebook Oversight Board Charter [online]. 2020 [viewed 2 October 2021]. Available from: https://oversightboard.com/governance/.

[20] Art. 18 (2) DSA.

[21] Art. 18 (2) b) DSA.

[22] MAK, Vanessa and BUSCH, Christoph. Putting the Digital Services Act in Context. *Journal of European Consumer and Market Law*, 2021, 10 (3). p. 109. Furthermore, it is necessary to remember that even a "human rights-centred" approach will not lead to a system that will please everyone: SANDER, Barrie. Freedom of expression in the age of online platforms: The promise and pitfalls of human rights-based approach to content moderation. *Fordham International Law Journal*, 2020, 43 (4), p. 968.

[23] Furthermore, there are numerous challenges in even determining whether a piece on online content *is* disinformation: See STEWART, Elizabeth. Detecting Fake News: Two Problems for Content Moderation. *Philosophy & Technology* [online]. 2021 [viewed 2 October 2021]. Available from: https://link.springer.com/content/pdf/10.1007/s13347-021-00442-x.pdf.

[24] See e.g. Twitter Hacked Materials Policy [online]. 2020. [viewed 2 October 2021]. Available from: https://help.twitter.com/en/rules-and-policies/hacked-materials.

[25] DOUEK, Evelyn. Governing Online Speech: From "Posts-As-Trumps" To Proportionality And Probability. *Columbia Law Journal*. 2021. 121 (3). pp. 800-802.

This requirement could (in practice) lead to a situation where DSBs prefer to only cover some specific areas of content moderation and content-related disputes, while some (more complicated) could be left without adequate attention. The aim of Art. 18 DSA would thus remain partially unfulfilled. Since the requirement of *necessary expertise* is organically connected to the scope of issues the DSA aims to settle with DSBs, the solution to this risk could lie rather in the lenient application of this standard, rather than in an amendment to Art. 18 DSA. To illustrate this further, the mechanism of settling disputes with an *internal* instance followed by an additional *out-of-court* layer was perhaps inspired by the "Platform-to-Business" Regulation, which provides for the possibility of out-of-court *mediation* of disputes.[26] However, DSA arguably lays down a much more stringent demand.[27]

Peculiarly, DSA does not seem to require that Art. 18 DSA proceedings be conducted in the official language of *every* Member State either (and thus the language used by *any* user or the language of *any* decisions reviewed by DSBs). Art. 18 DSA only asks that the proceedings are conducted in *at least one* EU official language.[28] In contrast, the Platform-to-Business Regulation requires that mediation be conducted *in the language of the terms and conditions*.[29]

Platforms operating in multiple Member States thus may find themselves in a situation where they provide internal dispute mechanisms in the local language, while Art. 18 DSA proceedings are only available e. g. in English. This creates a risk that platforms and users will have to navigate between environments with regularly used DSBs and those where courts provide the only language-friendly solution after the platform-provided procedures. Furthermore, Art.18 DSA also raises a question if all cases (especially those placed in a local context of a certain Member State) will be fully understood by DSBs that do not conduct proceedings in certain languages.[30]

On top of the abovementioned demands on expertise, Art. 18 DSA also generally requires that any dispute is settled in a *"swift, efficient and cost-effective manner"* and that users – if successful – are reimbursed for any procedural costs by the platform (while only carrying their own costs if they lose).[31] This is done in a push to make the new dispute resolution system more attractive

[26] Compare Art. 11-12 of Regulation (EU) 2019/1150 of the European Parliament and of the Council of 20 June 2019 on promoting fairness and transparency for business users of online intermediation services [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/ TXT/?uri=celex%3A32019R1150.

[27] Art. 12 of that regulation only requires that dispute settlement bodies have an understanding of *"general business-to-business commercial relations"*.

[28] Art. 18 (2) d) DSA.

[29] Art. 12 Regulation 2019/1150.

[30] Which would only add to the already often misunderstood content-related decisions, as seen by *users*: MYERS WEST, Sarah. Censored, suspended, shadowbanned: User interpretations of content moderation on social media platforms. *New media & Society*, 2018, 20 (11), p. 4372–4373.

[31] Art. 18 (2) d) and (3) DSA.

than going to Member State courts. It has, however, been argued, that cumulatively, DSA's requirements are too onerous for such a system to work and Art. 18 DSA is unrealistic in its demands.[32] On the other hand, Art. 18 DSA is not the only defence for users in Europe, who *are* in a position to take legal action against online platforms and raise arguments based on fundamental rights.[33] With the current generally worded version of DSA proposal, however (and in the absence of more detailed preparatory works), it is difficult to predict how will these requirements impact the practical operation of third-party dispute settlement.

## 3. THIRD-PARTY DISPUTE SETTLEMENT FROM THE POINT OF VIEW OF ONLINE PLATFORMS

Art. 18 DSA strengthens the position of users.[34] They can choose a forum for the dispute, force the platform to enter the proceedings and comply with the decision of the DSB. This protection is *"without prejudice to the right of the* [user] *concerned to redress against the decision before a court in accordance with the applicable law"*.[35] DSA thus creates a parallel dispute resolution system alongside national courts (covering *all decisions* under Art. 17 DSA, not just disputes that could not have been resolved).

Unfortunately, the current text of DSA a) neither mentions any remedies available to *online platforms* against DSB decisions under Art. 18 DSA, nor b) does it clarify the extent of any possible judicial review of DSB decision. It has been argued that online platforms would have no access to courts in areas covered by DSA.[36] This would turn Art. 18 DSA into a constitutional aberration – a provision aiming at providing more procedural tools for users but simultaneously preventing online platforms from challenging DSB decisions in courts.

However, Art. 47 of the Charter of Fundamental Rights of the EU guarantees *everyone* the right to an effective remedy (including a *hearing by an independent and impartial tribunal previously established by law*). According to the Court of Justice of the EU, the right to an effective remedy *"is inherent in the existence of the rule of law"*[37] and *"must be guaranteed even in the absence of*

[32] See Holznagel, op. cit. 18.

[33] KELLER, Daphne. Who do you sue. State And Platform Hybrid Power Over Online Speech. Hoover Institution, Aegis Series Papers no. 1902 [online]. 2019 [viewed 2 October 2021]. Available from: https://www.hoover.org/research/who-do-you-sue, 12 – 13.

[34] Though Art. 18 has been criticised in the paper, it undoubtedly helps to balance the imbalance of power between users and platforms: DE GREGORIO, Giovanni. Democratising online content moderation: A constitutional framework. *Computer Law & Security Review* [online] 2020, 36, [viewed 2 October 2021]. Available from: https://www.sciencedirect.com/science/article/pii/S02673 64919303851, p. 7 and 11.

[35] Art. 18 (1) DSA.

[36] See Holznagel, op. cit. 18.

[37] See para 95 of the Judgment of the Court of Justice of 6 October 2015. *Maximillian Schrems v Data Protection Commissioner*. Case C-362/14 [online]. In EUR-Lex. [accessed on 2021-01-10]. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:62014CJ0362.

*any rules governing the proceedings in question"*.[38] Any attempt to interpret or apply Art. 18 DSA in a way that would remove access to courts for online platforms would thus most likely fail as being contrary to the Charter.[39] In such an event, platforms could most likely rely directly on Art. 47 of the Charter and its direct effect even in horizontal relationships between them and their users.[40]

Art. 18 DSA should thus be amended and expressly include the possibility for platforms to challenge DSB decisions in "regular" courts. Furthermore, Art. 18 DSA should also clarify the *scope* of judicial review. DSBs will be most likely established as private bodies. On the other hand, they will have to balance various fundamental rights and other public policy reasons, while at the same time affecting content moderation strategies and practices of online platforms – thus significantly influencing their daily operation. Since participation in Art. 18 DSA proceedings is effectively forced on the platforms, it would not seem appropriate to subject DSB decisions only to *limited* judicial review (as would the case be in some jurisdictions e.g. with some arbitral awards).

## CONCLUSION

In conclusion, Art. 18 DSA aims to create an ambitious dispute resolution system. However, the paper identified some areas that could require amendment or improvement (if Art. 18 should remain in DSA).

The paper reviewed the requirements placed on dispute settlement bodies. DSA will require the establishment of *new* DSBs without dependence on platforms. However, DSA also requires that DSBs *demonstrate* necessary expertise in content moderation and platforms' policies, possibly putting a high burden on DSBs and limiting the availability of Art. 18 DSA proceedings for *all* kinds of disputes. Furthermore, Art. 18 DSA does not require that the proceedings are available in *any* EU official language, once more possibly creating a dispute resolution system limited in its scope and the users who enter such proceedings.

The paper also briefly discussed the position of platforms in this system. While Art. 18 DSA does empower users of online platforms, it seemingly forgets

[38] See para 83 of the Judgment of the Court of Justice of 26 September 2013. *Texdata Software GmbH*. Case C-418/11 [online]. In EUR-Lex. [accessed on 2021-01-10]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62011CA0418.

[39] It is unlikely that Art. 18 dispute resolution bodies could be considered as providing the necessary guarantees required by Art. 47 Charter; see further: LOCK, Tobias and MARTIN, Denis. Article 47. In: KELLERBAUER, Manuel; KLAMERT, Marcus; TOMKIN, Jonathan (ed.). *The EU Treaties and the Charter of Fundamental Rights: a commentary*. Oxford University Press, 2019, pp. 2215 – 2216.

[40] See para 78 of the Judgment of the Court of Justice of 17 April 2018. *Vera Egenberger v Evangelisches Werk für Diakonie und Entwicklung eV*. Case C-414/16 [online]. In EUR-Lex. [accessed on 2021-01-10]. Available from: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:6
2016CJ0414.

about platforms' own rights. The paper thus *inter alia* suggests amending Art. 18, as any interpretation that would remove recourse to courts for platforms would most likely fail.

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# Consumer protection in contractual practice of supply of digital content and digital services

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***Abstract:*** *The aim of this paper is to showcase the Czech and EU law that regulates supply of digital content and services and assess its general usefulness with regards to contractual practice and consumer protection. This is achieved primarily by analysing the present and upcoming law that regulates the said topic and its comparison with contractual practice on the market. The paper concludes, that in the digital market, consumers have little control over the contracts they can enter into. Many of these contracts are consumer-unfriendly or even illegal. The law offers several ways the consumer can defend their rights on the market, but these are not cost-effective.*

***Keywords:*** *digital content, digital service, Directive 2019/770, contractual practice, ADR.*

## INTRODUCTION

The modern concept of consumer protection was defined in 1962 by J.F. Kennedy.[1] [2] To be a consumer today means to be a natural person, that interacts with the market for the purpose of fulfilling their personal needs, not profit.[3]

A consumer has to face many challenges today. In an economy that is undergoing a digital revolution[4] many core concepts of trade change. As the importance of data grows, material items are no longer the dominant article of trade. In modern digital market, the main goods are not physical things, but accesses and contractual relationships.[5] A big part of this data supply can be classified as supply of digital content and/or digital services.

[1] The research, whose conclusions are presented in this paper, was conducted within the scope of a Specific research project funded by the Grant Agency of Masaryk University, Brno, Czech Republic, entitled „Výzkum smluvní praxe poskytování digitálních dat spotřebitelům“ (Research of contractual practice of supply of digital data to the consumer), MUNI/A/1296/2020.

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[3] EVERSON, Michelle. Legal Constructions of the Consumer. In: Knowing Consumers: Actors, Images, Identities in Modern History. Conference at the Zentrum für Interdisziplinäre Forschung [online]. Bielefeld, Germany: February 26-28, 2004. [viewed. 10 September 2021]. 6.

[4] MANNING, Patrick: Digital World History: An Agenda. Digital History Project [online]. 2007. [viewed. 10 September 2021].

[5] HURDÍK, Jan. Institucionální pilíře soukromého práva. Praha: C. H. Beck, 2007, 60.

As the market changes, so do its trappings: the digital world gives the suppliers many new tools to infringe on consumer rights, while rendering many methods of consumer defence obsolete. Much has been written about digital market and its contracts: for example, Natali Helberger analysed, how will the legal classification of digital content impact the rights of consumers,[6] Anil Kumar et al. built a model for consumer decision making on digital market.[7] This articles' original contribution is to analyse the contracts for the supply of digital content and digital services and to show how they fare with regards to consumer protection law applicable in the Czech Republic.

The hypothesis is as follows: "Contractual practice in the area of supply of digital content and services is generally consumer-unfriendly, often not in accordance with law, and existing tools of consumer protection are not viable for consumers themselves to use in the said area." The methods used to test the hypothesis will consist of describing and analysing the present and the future law that regulates digital content and services. The applicable law will be subsequently compared with data gathered from the field study. Procedural law of consumer rights enforcement will also be analysed and compiled to create a summary of consumers' options in defending their rights. Whether this hypothesis will be confirmed or disproven, the arguments will be summarized in the conclusion.

## 1. DIGITAL CONTENT AND DIGITAL SERVICES

Directive (EU) 2019/770 on certain aspects concerning contracts for the supply of digital content and digital services ("DCD") is a key legislative component of EU's Digital single market policy,[8] and a culmination of years-long legislative and political push, which started with Draft Common Frame of Reference in 2009.[9] This initiative has seen many earlier drafts fail for various reasons, the most prevalent one being their ambition to create a new legal framework with a wide contractual scope, [10] for which they were criticized and ultimately rejected

[6] HELBERGER, Natali et al. Digital Content Contracts for Consumers. *Journal of Consumer Policy* [online]. 2013, 36(3), 0168-7034. [viewed 8 September 2021].

[7] KUMAR, Anil, et al. Predicting changing pattern: building model for consumer decision making in digital market. *Journal of Enterprise Information Management* [online]. 2018, **31**(5), 674–703. ISSN 1741-0398 [viewed 21 September 2021]. 679.

[8] Long term plan of the EU to create Digital Single Market in its member states. Digital Single Market is one where individuals and businesses can access and exercise online activities under conditions of fair competition, and a high level of consumer and personal data protection, irrespective of their nationality or place of residence. See: Communication COM (2015) 192 final of 6th of May 2015, A Digital Single Market Strategy for Europe - Analysis and Evidence Communication from the Commission. [online]. In EUR-Lex.

[9] TWIGG-FLESNER, Christian. *Europeanisation of Contract Law*. Taylor & Francis Group, 2013. 85.

[10] WEBER, Rolf. H. The Sharing Economy in the EU and the Law of Contracts. *The George Washington Law Review* [online]. 2018, 85(6), 1777-1803. ISSN 168076. [viewed 10 September 2021]. 1795.

by member states. DCD will be effective from 1 January 2022 (Art. 24 of the DCD).

Digital content can be defined as data which are produced and supplied in digital form. Digital service is understood as a service that allows the consumer to create, process, store, share or otherwise interact with data in digital form (Art. 2 of the DCD). Since there is no practical difference between supply of these two categories, they will be referred to jointly as "digital content."

Digital content, is, however, not synonymous with data. There are many cases when provided data are not legally digital content. Electronic communications services, healthcare, financial services, free or open-source software, cinematographic projections and data supplied by public bodies are not digital content and do not share the same set of rules (Art. 2 (5) of the DCD). Digital content is also an exclusively consumer term; B2B contracts for the supply of data are not considered to constitute supply of digital content.

As of November 2021, there is little special regulation of digital content in Czech private law. The main contribution of DCD is the legal codification of technical terminology such as interoperability and compatibility, and the creation of basic framework for further regulation of consumer rights, both in EU and national law. The questions of specific changes that DCD will bring to the law of consumer protection and usefulness of DCD as a consumer protection tool are however not a subject of this article.

Digital content and digital services are an integral part of the market and society as a whole. Every computer program, every entertainment platform, every one of the dozens of mobile apps that a person uses daily is a digital content that is being/has been supplied. All of these are part of the ever-growing internet of things.[11] And all of these must be provided in accordance with law, specifically through private-law contracts.

## 2. RELEVANT CZECH CONSUMER PROTECTION REGULATION

The Czech consumer protection is regulated in two ways: the private part is in Article 1810 et seq. of the Act no. 89/2012 Coll., Civil Code, as amended ("Civil Code"), while the public part is regulated in a separate act, Act no.634/1992 Coll., Consumer protection act, as amended ("Consumer protection act").

Conceptually, the consumer protection is divided into four categories: right to information, right to safety, right to choose and right to be heard.[12]

[11] KUMAR, Anil, et al. Predicting changing pattern: building model for consumer decision making in digital market. *Journal of Enterprise Information Management* [online]. 2018, **31**(5), 674–703. ISSN 1741-0398 [viewed 21 September 2021]. 701.

[12] SKŘIVÁNKOVÁ, Kateřina. Consumer protection in European law. [online]. 2011. [viewed. 10 September 2021]. Dissertation thesis. Masaryk University, Brno. Thesis supervisor doc. JUDr. Filip Křepelka, Ph.D. 44.

The right to information is extensively regulated in Article 1811 of the Civil Code. It is however, open to interpretation, if this provision applies to all the supply of digital content. Article 1811 (3), letter a) states that the provision shall not be applied within dealings of everyday life. Can, for example, a content of low value and scope, such as mobile apps, be considered an everyday deal? Not yet, but legal practice might form a different binding opinion. It must also be said that consumers' right to information is not absolute: e.g., the seller is not obliged to inform the consumer about common dangers, that everyone should know.[13]

The other three rights are distributed between Articles 1810 and 1851 of the Civil Code, with little to none specifics regarding digital content. Though that is bound to change soon, with the inevitable transposition of the DCD into Czech law, if the proposed draft is to be enacted in its current form.[14]

Within the current understanding of contracts, the form contracts for the supply of digital content must be understood as written (Article 562 (1) Civil Code). However, there is no legal requirement for the written form: supply of digital content can be agreed upon orally, or even taciturn.

The Consumer protection act deals with the requirements for suppliers regarding prices, the concept of unlawful business practice, aggressive business practice and consumer discrimination. Many, if not all of the practices that infringe on consumer rights can easily be classified as unlawful business practice and are therefore punishable according to law.

There are other areas of law that contribute to a better position of consumers. The most relevant one is the Competition law, that regulates the market and the suppliers' actions on it. The extensive regulation in Article 2972 et seq. of the Civil Code describes many ways a supplier can infringe on fair competition and the Czech Republic and other EU nations have means to punish that behaviour.

## 3. CONTRACTS FOR THE SUPPLY OF DIGITAL CONTENT AND SERVICES

The information in this chapter was extrapolated from data gathered in a field study conducted by the author himself as part of a research project in 2021. The study examined 100 contracts for the supply of digital content, that supply content generally for use by consumers or it can be safely assumed that consumers use it (such as games, antivirus software, VPN, streaming services, music, e-books, operating systems etc.), across several platforms (such as PC, tablets,

[13] POSPÍŠIL, Michal. Povinnosti spotřebitelů ve vztahu k podnikatelům. In: Právo v podnikání vybraných členských států Evropské Unie – sborník příspěvků k IX. ročníku mezinárodní vědecké konference, 1. vydání. Praha: TROAS s. r. o., 2017, p 220, ISBN: 978-80-88055-03-7.

[14] CZECH REPUBLIC Draft No. 1170/19 of the act that amends the act No. 89/2012 coll. Civil code [návrh zákona, kterým se mění zákon č. 89/2012 Sb., občanský zákoník].

smartphones etc.). The sample was created as to cover many types of content, but also so that every type is represented more than once. Therefore, this chapter has minimal references. Because borders in the digital world and on the internet specifically are irrelevant, the sample does not consider the nationality of the supplier. However, a specific care was given to include semi-equal number of contracts from Czech suppliers, EU suppliers and third-state suppliers in the sample, to paint a complex picture of contracts a consumer may encounter on the market.[15]

The basic framework of a contract for supply of digital content is the same as in any trade: the rights and duties of both parties. However, in addition to performance and counter-performance of both parties the contract has to deal with several other areas that need to be regulated, both mandatory and necessary. These include, but are not limited to, license agreement, personal data handling and consumer clauses as required by both the Civil Code and the relevant EU law.

A contract is often no longer a signed sheet of paper. Modern contracts consist of several separate documents. In fact, 100% of the contracts for the supply of digital content in the sample consist of more than a single document, more than ¾ of them are made of more than two. Terms and conditions, as regulated by Article 1751 et seq. of the Civil Code are a common part of the contracts.

The study has shown that if the supplied content is software, it always has the relevant documents present in an installation process, where it needs to be agreed upon by the person installing the content, so that the installation may proceed. The supplier is responsible for the process of integration (Art. 9 of the DCD), meaning, that the supplied content has to work in the consumer's machine. The successful installation is a part of performance of the supplier, and it can even be argued, that it is a part of the contract itself. The installation is, however, most often unrepeatable without unreasonable difficulties. To rectify this problem, any and all provisions agreed upon during the installation must be accessible elsewhere.

In a standard situation (meaning the consumer does not go above and beyond of what would be considered normal behaviour) a consumer has a choice of accepting the contract as it is, or not. This adhesion, as defined by Article 1798 et seq. of the Civil Code, is present in 100% of the samples. When asked about an option of modification, none of the suppliers were open to negotiations, if they have responded at all.

In the cases of the co-called shrink wrap and click wrap contracts, the consumer can't even read the majority of the contract without entering into it first. While shrink wrap is on the decline, as the importance of physical media

[15] About 50 % of digital content supplied in the EU comes from the USA, about 30 % from third-state suppliers and only around 10 % comes from cross-border trade within the EU. See: Communication COM (2015) 192 final of 6th of May 2015, A Digital Single Market Strategy for Europe - Analysis and Evidence Communication from the Commission. [online]. In EUR-Lex.

fades, click wrap contracts are still common in online storefronts, that offer multiple content.

As for the legality of the contracts themselves, problems were found in 96% of the samples. Most of these issues were by omission, usually when the supplier neglected to inform the consumer about their rights, or interpretation of some of the stipulation was too vague. 12 of the contracts contained illegal provisions with regards to consumer warranty. 38 contracts also contained provisions that could be considered "surprising" and therefore null and void in accordance with Article 1815 of the Civil Code, with the most prominent example being a waiver of the right of withdrawal from a contract.

It is also worth mentioning that 99% of sampled contracts were supplied by artificial persons. It seems that natural persons rarely supply digital content to the consumers.

## 4. CONSUMER MEANS OF DEFENSE

### 4.1. Civil court action

As is the case with any real or perceived slight, the consumer has the right to take a legal action against the supplier. Czech law, however, does not provide any extra consumer protection in civil procedure. Meaning that currently the consumer needs to go through the same civil procedure as any other person. Nevertheless, the court proceedings are not free and the price of the content itself, while not cheap, is generally in the lower numbers: 100% of the samples weres not more expensive than 2000 Czech crowns. To put this into perspective: an appeal against a court verdict is not possible if the disputed subject of performance is valued less than 10 000 Czech crowns (Article 202 (2) of the Act No. 99/1963 Coll., the Civil Procedure Code), the lowest possible court fee is 400 Czech crowns (as per the second Section of the first addendum to the Act No. 549/1991 Coll., on court fees).

The consumer can offset the costs of a civil case by enlisting the help of non-profit consumer protection organizations. These organizations provide many services ranging from legal counsel to model documents.[16] But these are just stopgaps that mend the broken system; civil case cannot be at this point considered a viable option for enforcing consumer rights in contracts for the supply of digital content.

### 4.2. Public law institutions

The Czech Trade Inspection Authority monitors and inspects suppliers and service providers on the Czech market. Its scope of activity is regulated by

[16] SOS association. [online]. 2011. [viewed 20 September 2021].

several laws, most importantly the Consumer protection act and the Act No. 64/1986 Coll., the Czech Trade Inspection Authority Act. As far as digital content goes, it mainly oversees potential unlawful business practices.

The Czech National Bank oversees unlawful business practices, consumer discrimination, price information, and regulation.[17]

A consumer can tip off any unlawful conduct of the supplier, and the public-administration offices are legally required to deal with the tip, possibly investigate any claims and take proper action. Of course, punishment of the supplier does not directly benefit the consumer, since it has no effect on their private relationship. Therefore, from a consumers' perspective, one must consider these actions unviable either.

### 4.3. Alternative dispute resolution (ADR)

If a consumer thinks that they suffered prejudices from a supplier, they can try to seek an out-of-court solution; ADR. The ADR entity will process their submission and if the consumer's requirements are justified, the entity will ask the supplier to react in order to reach a solution of the particular dispute.[18] Suppliers are legally obliged to cooperate. If a supplier does not accept the proposed agreement, the ADR entity can issue a non-binding justified statement which can be used by the consumer as a proof in court.

ADR deals with disputes between consumers and suppliers residing or permanently based in any country of the EU.[19] Consumers can initiate an ADR in the period of 1 year after the first claim is made against the particular supplier. When initiating an ADR procedure, it is necessary to prove that an unsuccessful attempt to resolve the claim was made and the case is not *lis pendens*.[20] In the Czech Republic, the ADR is under the jurisdiction of Czech Trade Inspection Authority and it is without fees.[21]

While ADR is free, it still takes consumers' time. Moreover, the final result of the ADR is not guaranteed, and even in the case of a completely valid claim, the consumer might need to go to court anyway. Economically speaking, this simply cannot be considered practical when it comes to digital content.

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[17] Consumer protection. Czech National Bank [online]. 2021. [viewed 19 September 2021].

[18] KNUDSEN, Laine Fogh, and Signe BALINA. Alternative dispute resolution systems across the European union, Iceland and Norway. *Procedia - Social and Behavioral Sciences* [online]. 2014, **109**. ISSN 1877-0428 [viewed 21 September 2021]. 946.

[19] KNUDSEN, Laine Fogh, and Signe BALINA. ibid. 949.

[20] Pending case, meaning that the case is being dealt with elsewhere, be it another ADR entity or court.

[21] Information about Alternative dispute resolution (ADR). Czech Trade Inspection Authority [online]. 2021. [viewed 19 September 2021].

## CONCLUSION

The main hypothesis was shown to be correct. The vast majority of contracts are legally problematic in one way or another, ranging from providing insufficient information to the consumer to downright illegal provisions and traditional legal instruments of consumer protection, that consumers themselves can use, are not economically viable. A court case is simply too expensive and time consuming. The relatively new institute of ADR is useful, but time consuming as well, and should be considered as the first step in the arduous path of building an efficient system of legal consumer protection. Other means of action, such as alerting public institutions to possible breaches of law, do not carry consumer renumeration.

If there is to be an improvement, new legal proceedings and institutions must be created. The oft-cited inspiration can come from Scandinavian countries and their consumer arbiters and class action lawsuits. The EU is not passive in this area either, with its initiative to empower consumers and create efficient legal instruments to enforce their rights through for example collective redress.[22] One must also factor the technological aspects of the market in solving its problems. Because as technology improves, the issues in the market need not be solved by legal regulation, but can be solved instead by technology itself. This concept was dubbed Law 3.0 by Brownsword.[23] To cite an example, there is a public safety need to bar remote-controlled drones from flying too close to the airport. Rather than to create a law that forbids it, and the infrastructure needed to enforce the said law, the airports can simply deploy a field that disables any drones that fly into vicinity.[24] Such solutions can be envisioned in for example ensuring interoperability of the digital content. Law 3.0 has the capacity and, in my opinion, economic viability to be the best approach to many problems on the digital market.

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[24] BROWNSWORD, Roger. ibid. 18

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# SECTION VI
# INTERFERENCE OF BUSINESS AND CONSTITUTIONAL LAW

# Restriction of ownership rights as an interference with freedom of enterprise

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***Abstract:*** *This paper is dedicated to business aspects of expropriation and further restrictions of ownership executed by state authorities. While strict proprietary implications of ownership restrictions seem to be self-explanatory and to arise from the very nature of such intervention, the business-oriented purpose of the affected estate is being taken into consideration rather exceptionally. Although such approach is partially based on the causal nexus limitations implemented during the establishment of value of the property as potential (and in many cases even hypothetical and speculative) use of the property cannot be perceived as a matter of course, in certain cases such use must be diligently considered in order to determine the actual extent of intervention into the constitutionally guaranteed rights. Using synthesis and analysis of current legal regulation, this paper aims to identify the implications of ownership restriction for business and suggest criteria for the assessment of the value of expropriated estate.*

***Keywords:*** *ownership restriction; expropriation; freedom of enterprise; compensation for loss of business advantage; investment protection.*

## INTRODUCTION

Restriction of ownership rights through so-called expropriation proceedings (or even prior to engaging in such proceedings) can be hardly labelled a new legal instrument[1]. References to expropriation[2] can be found as

[1] The research presented in this paper was carried out with financial support from the specific university research scholarship (SVV) No. 260 496 "Ownership and its limitation in the mirror of legal dualism" granted by Charles University, Prague.

[2] Although the verbatim and *stricto sensu* meaning of the word "*expropriation*" (consisting of a prefix "*ex*" standing for "out of" and the word "*proprietas*", i.e. property or ownership) suggests that the process of expropriation ought to lead to an absolute deprivation of ownership rights, in modern legislation such term normally stands for any restriction of proprietary rights. For instance, Czech Act No. 184/2006 Coll., on Expropriation and Restriction of Ownership Rights to Land or Construction (Expropriation Act) defines expropriation as an act of both "*revocation [and] restriction of the right of ownership*".

early as in the second book of Samuel dating back to the sixth century B.C.,[3] although modern use of expropriation is commonly associated with the construction of railways and other transport infrastructure.[4] Despite the fact that expropriation *per se* has been subject to extensive research and numerous court decisions, most of scholarship have so far focused predominantly on the constitutional conformity of this intervention and its conditions, rather than the compensation for the expropriated estate.[5] Even less attention has been paid to the influence of expropriation on business activities and entrepreneurship as law traditionally based the provision of compensation on the property and its static value at the time of expropriation.

While the meaning of expropriation and its significance from the viewpoint of private property (or rather right *to* property) is quite obvious, and expropriation in commonly perceived as an interference with the constitutionally guaranteed right to own property, further implications of this act are generally overlooked. At the same time, aspects having vital impact on the precise determination of compensation can be also found in other constitutional rights, in particular the right of entrepreneurship commonly referred to as the freedom of enterprise. In this paper, the author looks to identify the ways expropriation may interfere with the freedom of enterprise and to suggest criteria for determining compensation for the expropriated estate based on dynamic rather than static value of such property. To achieve the outlined objectives, the author uses a synthesis of existing knowledge and data in the relevant field and subjects it to doctrinal analysis.

[3] REYNOLDS, Susan. *Before Eminent Domain: Toward a History of Expropriation of Land for the Common Good*. Chapel Hill: University of North Carolina Press, 2014. ISBN 9781469622194, pp. 9-24.

[4] Already Otto's educational dictionary connects expropriation with the construction of railway trails. See OTTO, Jan. *Otto's Educational Dictionary: An illustrated encyclopaedia of general knowledge*. Twenty-seventh part. Vůz - Zyzkowski. Prague: J. Otto, 1908, pp. 79-80. See also PRAŽÁK, Georg. *Das Recht der Enteignung in Österreich*. Prague: H. Mercy, 1877, pp. 114-128. See also AZUELA, Antonio, and Carlos HERRERA-MARTÍN. Taking Land Around the World: International Trends in Expropriation for Urban and Infrastructure Projects. In: *Urban Land Markets*. Dordrecht: Springer Netherlands, 2009, pp. 337–362. ISBN 9781402088612. Available from: doi:10.1007/978-1-4020-8862-9_13.

[5] It must be noted that this topic has been *in generalia* elaborated by some authors, yet without comprehensively taking into account all aspects of compensation. See e.g. SCHACHTER, Oscar. Compensation for Expropriation. American Journal of International Law. 1984, 78 (1), 121–130. ISSN 2161-7953. Available from: doi:10.2307/2202344. Some very practical hints regarding the establishment of compensation can be also found as early as in 19th century German literature, see e.g. BÄHR, Otto. Entschädigung im Enteignungsverfahren. In: *Urteile des Reichsgerichts mit Besprechungen*. München: De Gruyter Oldenbourg, 1883, ISBN 9783110680379. Available from: doi:10.1515/9783110680379-024, pp. 192–204.

## 1. OWNERSHIP RESTRICTION AND EXPROPRIATION PROCEDURE

The course and conception of the expropriation procedure may vary from jurisdiction to jurisdiction. In general, two indispensable phases and two separate parts of such procedure can be identified, as will be further shown on the example of Czech model of expropriation proceedings.[6] Firstly, deprivation of a right of ownership ought to be considered an *ultima ratio* measure, meaning that not only must expropriation be absolutely inevitable and there must be no other way to satisfy public interest, but also that other, amicable attempts to acquire ownership rights should be made prior to engaging in a formal procedure before a public authority.[7] Secondly, should the attempts to resolve the problem contractually fail and administrative (or court) proceedings take place, two separate *quaestiones juris* ought to be resolved: a question of expropriation *per se*, and eventually a question of compensation for the expropriated estate.[8]

As for the stage preceding the initiation of expropriation procedure, in addition to contractual negotiation, this phase may also include a preliminary inspection of the property in question. Such inspection typically comes in place in cases requiring geological analysis of terrain in order to establish whether the selected estate is technically capable of allowing to achieve the desirable goal. Although this step is vital in terms of fulfilling the *ultima ratio* nature of expropriation, i.e. proving its *suitability*,[9] it also constitutes a major intervention

[6] Even though Germanic legal doctrine can be said to be the most advanced and elaborated when it comes to expropriation, having a long tradition of both scholarship and decision-making, the author holds the opinion that Czech expropriation legislation can expose problematic aspects of expropriation from the business point of view. Ironically enough, some of these problems had been caused by an improper transposition of originally German instruments, such as preliminary transfer of possession. See BERGER, Anja. *Die vorzeitige Besitzeinweisung: Eine Untersuchung zur Optimierung des Instruments zur beschleunigten Vorhabensrealisierung*. Heidelberg: Mohr Siebeck, 2016, ISBN 9783161548291, pp. 48-51.

[7] See e.g. ŠUMRADA, Radoš, Miran FERLAN, and Anka LISEC. Acquisition and expropriation of real property for the public benefit in Slovenia. *Land Use Policy*. 2013, 32, ISSN 0264-8377. Available from: doi:10.1016/j.landusepol.2012.10.004, pp. 14–22. See also VLACHOVÁ, Barbora. Aktuální otázky vyvlastnění v režimu zákona o urychlení výstavby. *Bulletin advokacie*, 2019, No. 6, ISSN 1210-6348, pp. 21-25.

[8] This model of expropriation proceedings has been historically developed by German and Austrian legal doctrine already in 19th century; see PRAŽÁK, Georg. *Das Recht der Enteignung in Österreich*. Prague: H. Mercy, 1877, pp. 185-186. See also FRUMAROVÁ, Kateřina. Soudní ochrana ve věcech vyvlastnění, její specifika a problematické aspekty. *Bulletin advokacie*, 2020, No. 6, ISSN 1210-6348, pp. 24-25. See also HANDRLICA, Jakub. Řízení o odnětí nebo omezení vlastnických práv k nemovitostem nově. *Právní rozhledy*, 2013, No. 7, ISSN 1210-6410, pp. 229 ff.

[9] The term *necessity* is being used by the author as a reference to the so-called proportionality test, as formulated by the Czech Constitutional Court. This test, used for the purpose of assessment of proportionality (*largo sensu*) of an interference with a constitutional right, consists of three steps:

into privacy of the property owner. For instance, German legislation in several cases (e.g. road construction) allows the expropriator to demand a preliminary transfer of possession of the to-be-expropriated property, if it is necessary to commence the construction works immediately.[10] Thus, implementation of the expropriation title[11] may begin prior to issue of the decision *in merito*.[12] Similarly, Czech Line-Construction Act provides that everyone is obliged to enable the performance of measurements and survey work connected to the preparation of transport, water or energy infrastructure construction, even before the commencement of the construction procedure.[13]

Once expropriation proceedings commence, an expropriating authority first assesses whether legislative requirements for expropriation are met, and – should it find that relevant conditions are fulfilled – then decides on the amount of compensation.[14] The public authority issues a decision with two independent operative parts, each allowing a separate appeal and review: one on expropriation and one on compensation.[15] The amount of compensation is usually determined based on an expert witness report, meaning that the public authority ought to rely on the opinion of an expert carrying out an evaluation of the property based on methodology chosen either by the expropriatee or by the expert themselves.[16]

Although compensation is often confused with the economic value of a property, just like damages, it is rather a legal concept requiring an authoritative interpretation. It is compensation that ought to reflect the business purpose of the property, as compensation can *de facto* be considered to match the selling price of the property.[17]

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test of suitability, also referred to as test of capability (is the assessed measure capable of achieving the intended goal), test of necessity (is the implementation of the assessed measure necessary to achieve the goal), and test of proportionality *stricto sensu* (is the assessed measure proportional and reasonable in relation to the affected right). See e.g. ONDŘEJEK, Pavel. Limitations of Fundamental Rights in the Czech Republic and the Role of the Principle of Proportionality. *European Public Law*, 2014, Issue 3 (20), pp. 451-465.

[10] See e.g. Sec. 40a of Baden-Württemberg Act No. GBl. S. 330, 683 – Straßengesetz (Road Act) or Sec. 116 of German Construction Code (Act No. BGBl. I S. 2414, Baugesetzbuch).

[11] *Terminus technicus* standing for the purpose of expropriation.

[12] See BERGER, Anja. *Die vorzeitige Besitzeinweisung: Eine Untersuchung zur Optimierung des Instruments zur beschleunigten Vorhabensrealisierung*. Heidelberg: Mohr Siebeck, 2016, ISBN 9783161548291, pp. 48-51.

[13] See Sec. 2f of Czech Act No. 416/2009 Coll., on Accelerating the Construction of Transport, Water, Energy and Electronic Communications Infrastructure (Line-Construction Act).

[14] See e.g. Sec. 10-14 of Czech Act No. 184/2006 Coll., on the deprivation or restriction of ownership of land or buildings (Expropriation Act).

[15] Ibidem, Sec. 24 paragraph 2.

[16] Ibidem, Sec. 20 paragraph 1.

[17] In some jurisdictions, expropriation may even have a form of a so-called compulsory purchase. See GROVER, Richard. Compulsory purchase. *Journal of Property Investment & Finance*. 2014, 32 (5), ISSN 1463-578X. Available from: doi:10.1108/jpif-05-2014-0035, pp. 518–529.

## 2. INTERFERENCE WITH BUSINESS ACTIVITIES

An interference with entrepreneur activities comes into consideration if the expropriated estate is directly or indirectly used for business operation. Provided that, in case the property is used for a business purpose, it is substantive to diligently consider what can be called a *dynamic* value of the property, as opposed to its *static* value. In case of static assessment, property value is established based on its isolated market price at a particular point in time. On the other hand, dynamic assessment implies that value of the property is established considering its potential revenues, as well as an increase in selling price. Although such assessment is desirable in order to determine the fair amount of compensation, it is also highly problematic to distinguish estate dedicated to business purposes from estate that is not, as in both cases such estate has dynamic potential. It is, however, possible to outline at least rough factors to be considered, as will be shown in sub-chapters below.

### 2.1. Loss of investment potential

In most cases, the property in question constitutes a long-term investment and is expected not only to generate regular income (*inter alia* in a form of a rent), but also to increase in value over the course of time. The investment purpose of the property is naturally thwarted by expropriation, which might be problematic – apart from consequences for business – also from the viewpoint of international investment protection.[18]

Although the thwarting of an investment undoubtedly is an unfortunate *force majeure* that can unfavourably influence a business plan, two factors must be considered when determining the degree to which the investment potential will be reflected in the amount of compensation. Firstly, it is necessary to consider the causation[19] between the ownership of the property and any eventual yield. Since the investment potential is uncertain, the question might be raised whether it is appropriate to consider it in full due to the possible interruption of the causal nexus. Secondly, even though the initial investment might be thwarted, the expropriatee can always reinvest the money received in a form of compensation. Thus, the business intention can still be achieved regardless of expropriation. It is, however, important to bear in mind that an investment is always uncertain from its very nature; any obstacles arising during its course

[18] See e.g. HERZ, John H. Expropriation of Foreign Property. *American Journal of International Law*. 1941, 35(2), ISSN 2161-7953. Available from: doi:10.2307/2192262, pp. 243–262. See also THOMAS, J., and T. WORRALL. Foreign Direct Investment and the Risk of Expropriation. *The Review of Economic Studies*. 1994, 61 (1), ISSN 1467-937X. Available from: doi:10.2307/2297 878, pp. 81–108.

[19] Also referred to as causal connection or causal nexus.

should therefore not be automatically perceived as a profit loss.

In some cases, however, the potential return might be so significant that it might be nearly impossible to achieve a comparable return via other investment instruments (e.g. in case of highly lucrative real estate that is so to say one of a kind). The existence of such a unique investment may constitute a reason to grant a higher compensation and its uniqueness could therefore be considered by an expropriating authority. A similar approach can be adopted also in case property is occupied by a tenant willing to pay an above-market price for the reasons of personal preference. Although not automatically, such loss of profit should also be taken into consideration.

Needless to explicitly mention, the fact that the expropriated estate was meant to be used for business purposes ought to be proven during the proceedings. The mere potential for the property to be used to generate income is highly speculative, and thus should not be automatically considered without further evidence of such intention.

Despite the fact that the aforementioned scenarios may seem unlikely to happen, the question of investment property expropriation is as relevant as ever. A recent example of an expropriation incentive concerning investment property can be found in Berlin, where inhabitants voted in favour of expropriation of real estate owned by big property owners (landlords) in a referendum.[20] Although non-binding, this referendum shows that interference of expropriation with business activities is not merely theoretical and has potential of becoming a hot topic in future. Examples of ownership restrictions interfering with business can also be found among crisis measurements adopted during the COVID-19 crisis, when many states enacted termination bans or rent freezing upon landlords.[21] Although the owner is not deprived of the property in full, such measures also restrict the execution of ownership rights and thus interfere with business.

### 2.2. Loss of clientele or location advantage

Apart from investment purpose, expropriated estate may also be used directly for the operation of other business, typically as an office or a registered

[20] See e.g. ALKOUSAA, Riham and Matthias INVERARDI. Berliners vote to expropriate large landlords in non-binding referendum. *Reuters* [online]. 2021. [viewed on 3. 10. 2021]. Available from: https://www.reuters.com/world/europe/berliners-vote-expropriate-large-landlords-non-binding-referendum-2021-09-27/. See also SOLOMON, Erika. Berlin voters back call for property expropriation. *The Financial Times* [online]. 2021 [viewed on 3. 10. 2021]. Available from: https://www.ft.com/content/dfabdf27-0d85-4659-9a65-2e84ada7bb0b. Further see: Berliners in favor of measure to expropriate 240,000 flats. *The Independent* [online]. 2021 [viewed on 3. 10. 2021]. Available from: https://www.independent.co.uk/news/world/europe/berlin-social-democrats-b1927568.html.

[21] See e.g. Nařízení o zrušení zmrazení nájemného u bytů bude účinné od zítřka. *Advokátní deník* [online]. 2021 [viewed on 4. 10. 2021]. Available from: https://advokatnidenik.cz/2020/06/04/narizeni-o-zruseni-zmrazeni-najemneho-u-bytu-bude-ucinne-od-zitrka/.

seat. Whilst in case of some businesses, the offices are quite simply replaceable as their business operation is not dependent upon a certain location, other businesses derive a substantial part of their success from geographical or demographical factors. For instance, businesses such as restaurants, convenience stores or newspaper stands are almost entirely location based. Thus, for many businesses, location is to be considered a significant competitive advantage.[22]

Furthermore, while some businesses are location-dependent and yet are not based on a stable group of customers (the customer base fluctuates), others tend to have a loyal clientele. The attractiveness of business for such clientele may, however, be also partially based on a certain location. An example of such business can be found in the system of general practitioners (also referred to as district practitioners in some jurisdictions) providing healthcare based on the geographical principle. Should the estate used for business operation be expropriated, following relocation of business premises may cause the loss of clientele vital for the operation of business. A parallel to that situation can be found in quite casuistic provisions of the Czech Civil Code[23] anticipating that customer base may be overtaken by another business as a result of premises transfer.[24] In case of this provision, the legislator points out the need to compensate for the loss of clientele, thus explicitly stating that customer base is to be considered a substantial business asset. Analogically, this approach can (and, in the opinion of the author, also should) also be applied in case of expropriation where similar criteria can be used to determine the loss of profit.

As in the aforementioned situations concerning the loss of investment potential, also here the use of the property in a particular way must be subject to burden of proof.

## 3. SPECIFIC ASPECTS OF PRELIMINARY ACTIONS AND REGULATED ENTREPRENEURSHIP

Whilst the repercussions of the completed expropriation proceedings are evident and only raise the question of the fair amount of compensation, as suggested above, business activities can be considerably affected already prior to such proceedings. As the very nature of preliminary actions (primarily geological survey) suggests that these can be invasive and cause damages that will not be subject to consideration during the expropriation procedure as such since this procedure is uncertain to even begin in the first place, legislation tends to foresee

[22] See PORTER, Michael E. The Role of Location in Competition. *International Journal of the Economics of Business*, 1994, 1 (1). Available from: doi.org/10.1080/758540496, pp. 35–40.
[23] See Sec. 2315 of CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code.
[24] See VRÁNA, Lukáš. Převzetí zákaznické základny může přijít draho. *EPRÁVO.CZ* [online]. 2016, ISSN 1213-189X [viewed 2.10.2021]. Available from: https://www.epravo.cz/top/clanky/prevzeti-zakaznicke-zakladny-muze-prijit-draho-100654.html.

the damages from the beginning and provide for their indemnification.[25] However, what is often not considered is immaterial intervention connected with preliminary actions.

The first aspect to be taken into consideration is that some regulated businesses have classified correspondence and files as one of their main attributes. For instance, legal or healthcare services are granted client-attorney or doctor-patient privileges that are constitutionally protected.[26] When carrying out invasive surveys, appointed persons may acquire access to confidential documents, meaning that pre-expropriation actions could be potentially used as a false pretence. Such intervention can also naturally cause a disruption in the provision of services.

The second aspect to be considered is that even preliminary inspections or surveys may damage the inspected property in a way making it impossible to use it for its initial purposes. *Exempli gratia*, Czech Line-Construction Act does not distinguish between land plots and constructions, as both fall under the definition of real estate.[27] Thus, the cited law formally[28] allows to carry out geological works even in enclosed premises and other constructions. The business purpose of the property may then be thwarted by the very works preceding the expropriation, factually causing the same consequences as expropriation itself.

Last but not least, since the conditions under which preliminary inspections can be carried out are not further specified, allowing the potential infrastructure developer to consider several alternative routes, exploratory works can be misused for the purpose of liquidation of business competitors. Without properly assessing all the entrepreneurial aspects of this intervention, the actual extent of the intervention cannot be fully reflected.

## CONCLUSION

As discussed above, a restriction of ownership rights may directly or indirectly interfere with business. Thus, it is vital to consider the loss of potential business profit when determining the compensation for expropriation of property used for entrepreneurial activities. Such approach may be primarily adopted in

[25] See Sec. 2f of CZECH REPUBLIC Act No. 416/2009 Coll., on Accelerating the Construction of Transport, Water, Energy and Electronic Communications Infrastructure (Line-Construction Act).
[26] See also DANKO, Filip. Urychlení výstavby: měření a průzkumné práce prováděné oprávněným investorem na cizím pozemku bez souhlasu jeho vlastníka. *EPRÁVO.CZ* [online]. 2019, ISSN 1213-189X [viewed 4. 10. 2021]. Available from: https://www.epravo.cz/top/clanky/urychleni-vystavby-mereni-a-pruzkumne-prace-provadene-opravnenym-investorem-na-cizim-pozemku-bez-souhlasu-jeho-vlastnika-108916.html.
[27] See Sec. 2f of CZECH REPUBLIC Act No. 416/2009 Coll., on Accelerating the Construction of Transport, Water, Energy and Electronic Communications Infrastructure (Line-Construction Act).
[28] Although grammatical interpretation of the law seems to allow such intervention, the author finds it very unlikely that such approach would pass the proportionality test.

case of investment properties both generating a stable month-to-month income and potentially increasing in price based on market development. In this regard, however, the causal nexus between the expropriation and the loss of profit must be assessed, as firstly, investment return is uncertain from its very nature and cannot be guaranteed, and secondly, compensation can be further reinvested. Rights of ownership to the investment property can also be restricted in other ways, e.g. through crisis measures preventing landlords from certain disposals with their property.

It is also desirable to consider further side effects of expropriation on business operation, such as loss of a stable and long-term customer base or loss of competitive advantage based on location of the property. In this regard, compensation should be granted based on the same principles as indemnification and should not be based merely on the static value of the property. To achieve this, compensation for expropriation must be treated as a *quaestio juris* and not be degraded to an economic value determined based on methodology chosen by an expert witness.

Apart from effects of expropriation *per se*, business activities may be disrupted already prior to the expropriation proceedings, typically through preliminary actions such as a geological inspection of the property. Such an exquisite intervention can not only disable entrepreneurial activity, but also provide access to enclosed business premises and even potentially endanger certain privileges associated with secrecy.

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# Comments on the jurisprudence of the Constitutional Court of the Czech Republic on copyright

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***Abstract:*** *This paper focuses on the analysis of the application of the principles and provisions of constitutional law to the area of copyright in selected case law of the Constitutional Court of the Czech Republic and confirms their general importance, which manifested itself in the problems of legislation and case law during the Covid-19 pandemic. The starting point is to identify the principles and individual provisions of the constitutional law of the Czech Republic applicable to the protection of intangible objects of copyright, in particular the provisions of Art. 34, (1) Charter of Fundamental Rights and Freedoms of the Czech Republic on the protection of the results of creative intellectual activity. The aim is to find out how the Constitutional Court resolves conflicts between individual constitutional rights when they are infringed. Further goal is to consider the concept of constitutional protection of this field in the Czech Republic to compare with the concept of constitutional EU law and with international law. This will be done using the method of analysis and legal comparison.*

***Keywords:*** *copyright, constitutional protection of copyright, case law of the Constitutional Court of the Czech Republic, concept of constitutional protection of copyright in the Czech Republic, constitutional court.*

## INTRODUCTION

This article follows up on the contribution that the author presented at this conference in 2019 - on the topic of resolving disputes in the field of employee inventions and case law, which were issued by Czech courts.[1] This led him to analyse the case law in another area of intellectual property - at the application level of the Constitutional Court of the Czech Republic in the field of copyright, on which this article is based.[2] Based on this case law, the paper identifies

[1] BOHACEK, Martin. *Resolution of disputes on employee inventions and selected court decisions in the Czech Republic and Germany*. In: Law in Business of Selected EU Member States - Proceedings of XI. Annual International Scientific Conference, 1st edition. Prague: TROAS, 2019, pp. 45, 288 pp., ISBN 978-80-88055-08-2.

[2] BOHACEK, Martin. *Copyright in the light of constitutional law and the decision of the Constitutional Court of the Czech Republic*. In FISCHEROVÁ, Iva et al. (ed.). Tribute to Professor Karel Klima. Prague: Wolters Kluwer ČR, 2021, 17 pp. (forthcoming).

individual provisions of the Czech constitutional law applicable to copyright protection, in particular the provisions of Article 34 (1) of the Charter of Fundamental Rights and Freedoms of the Czech Republic (hereinafter the Charter)[3] on the protection of creative intellectual activity. The problems that the regulations adopted during the Covid-19 pandemic have had in this direction over the past two years have shown how important the constitutional foundations of individual disciplines and the judicial activity of Czech and European courts are.[4]

In the cases analysed, the Constitutional Court sometimes had to deal with the simultaneous protection of other constitutional rights, which may have conflicted with the protection of copyright. The goal of this article is therefore to find out how the Constitutional Court resolves possible conflicts between individual constitutional rights in the event of their violation (and defines the status of the mentioned Article 34 (1) of the Charter with respect to them) and which of them are most often applied.

In the next step, the author assesses this protection in terms of the whole sub-field of intellectual property law and another goal is a general view of the concept of constitutional protection of this field in the Czech Republic compared with the concept of EU constitutional law and international law and while considering the nature of intellectual property law in general.[5] The method of analysis, induction and legal comparison will be used to this end.

## 1. COPYRIGHT AND PROVISIONS OF THE CHARTER APLICABLE FOR ITS PROTECTION

Copyright is regulated in the Czech Republic in the Copyright Act and includes both copyright to copyright works and rights related to copyright - the right of a performer to their performances, the right of a producer of a sound recording to their recordings, the right of a producer of an audio-visual recording to their recording, the right of a radio and television broadcaster to broadcast it, the right of the publisher to a work not yet published, the right of the publisher to remuneration and the right of the database developer to its content.[6]

Copyright is understood as a part of intellectual property law, together with industrial property law and with regard to intangible assets not falling into

[3] Resolution of the Presidium of the Czech National Council No. 2/1993 Coll., On the promulgation of the Charter of Fundamental Rights and Freedoms as a part of the constitutional order of the Czech Republic.

[4] In these aspects this article was created within the solution of the IGA project "Recent changes in the field of business, financial and IT law in the Czech Republic in response to the Covid-19 pandemic", no. F2 / 60/2021.

[5] The philosophical foundations of copyright are also reflected in the constitutional concepts. intellectual property in general, especially its link to freedom – see also HUGHES, Justin. The Philosophy of Intellectual Property. Georgetown Law Journal, 1988, 77 (2), pp. 287-366, ISSN 0016-8092.

[6] Provisions of § 1 of the Copyright Act, Act No. 121/2000 Coll., as amended.

these two groups, such as goodwill, domain name, individual data, etc., as well as their protection against unfair competition, or as part of an even broader field of "rights to intangible property", as is traditionally deemed in legal theory.[7]

To protect copyright, as defined above by copyright law, it is possible to use mainly Article 34 (1) of the Charter, according to which the rights to the results of creative intellectual activity are protected by law, but also Article 11 of the Charter, which generally protects property (tangible and intangible), and, in general, Article 26 (1) of the Charter on the protection against unfair competition in the field of the right to conduct a business or other economic activity.

Of course, in various situations and aspects of copyright and the entire intellectual property it is also possible to apply other provisions of the Charter, or principles of constitutional law, such as Article 8 (protection of personal liberty), Article 10 (protection of personal honour, reputation and personal data), Article 15 (freedom of thought, scientific research and artistic creation), Article 17 ( freedom of expression and the right to express one's views orally, in writing, in print, in images or otherwise, as well as to freely seek, receive and impart ideas and information regardless of state borders and inadmissibility of censorship), Article 36 (right to judicial and other legal protection), Article 38 (prohibition on depriving a legal judge whose jurisdiction is provided for by law of the right to comment on all evidence taken).

## 2. SELECTED DECISIONS OF THE CONSTITUTIONAL COURT OF THE CZECH REPUBLIC OVER COPYRIGHT AND RELATED RIGHTS

The case law of the Constitutional Court of the Czech Republic participates in the interpretation of its constitutional order influencing the practice of general courts in principle in the formation of concepts of the constitutional basis of rights in individual branches of law.[8]

In the field of copyright and related rights, but intellectual property in general, the Constitutional Court of the Czech Republic (hereinafter the CC) has issued relatively fewer judgments, in contrast to the general Czech courts and the CJEU, to which the CC refers in some cases.

### 2.1. Submission of a preliminary reference by the Czech General Court to the Court of Justice of the EU in the field of copyright

The CC assessed a complaint on the resolution of the dispute over the

[7] In Czech legal theory, especially KNAP, Karel et al. *Intangible property rights*. Prague: CODEX, 1994, 245 pp., ISBN 80-901185-3-4, more recently BOHÁČEK, Martin and Ladislav JAKL. *Intellectual property law*. Prague: University of Economics, 2002, p. 10, 324 pp., ISBN 80-245-0463-4

[8] In general - KLÍMA, K. *Interpretation of law by constitutional courts (theoretical reflections).* 1st edition. Pilsen: Ales Cenek, 2006, ISBN 80-86898-82-2.

collective administration of copyright before the Municipal Court in Prague (as a general court), stating that this court did not submit to the Court of Justice of the EU (CJEU) a so-called preliminary reference to assess aspects of EU law in the case. The CC stated that the Municipal Court in Prague erred in failing to deal with the EU dimension of the solved case, as collective administration can be considered a service within the meaning of Article 56 et seq. Treaty on the Functioning of the EU (TFEU) and the activities of the collective rights administrator may have an effect on competition within the European Union within the meaning of Article 101 et seq. TFEU.

The complainant has the right to exhaust all means provided for by the legal system to protect their right, and therefore the Municipal Court in Prague, as a court of last instance in the case, violated their right to a legally authorised judge under Article 38 (1) of the Charter, when the court by wanton (contrary to Article 2 para. 3 of the Constitution of the Czech Republic in conjunction with Article 4 para. 4 of the Charter) did not submit to the CJEU the preliminary question. According to the CC, the arbitrariness is shown by a decision of a general court which does not react in any way to the fact that there is no settled case law of the CJEU on the given problem or the given case law does not cover the entire issue.

The judge of the Constitutional Court, Dagmar Lastovecka, had a dissenting opinion, according to which failure to submit a preliminary reference constitutes a violation of the right to a fair trial under Article 36 (1) of the Charter[9] and not removal of a case from a legally authorised judge pursuant to Article 38 (1) thereof.[10]

### 2.2. Parody and caricature as a legal exception (statutory licence, fair dealing) to the exclusive copyright

A big Czech power enterprise CEZ, plc. had two videos promoting its activities and owned exclusive rights to use them granted to CEZ by their author. In December 2018, the Greenpeace CR NGO (hereinafter referred to as Greenpeace) replaced CEZ's original video with footage of damaged, dry and felled forests and forest fires, supplemented by the description: "CEZ's coal flue gases are damaging trees. The result is forest fires." As part of its critical campaign, the modified video was embedded by Greenpeace on its Facebook page and thus operated. In February 2019, CEZ filed a lawsuit against Greenpeace requesting the defendant to cease dissemination the video and to publish an apology. The

[9] GRMELOVÁ, Nicole. Nepoložení předběžné otázky Soudnímu dvoru Evropské unie jako porušení práva na spravedlivý proces. (Failure to make a preliminary reference to the Court of Justice of the European Union as a breach of the right to a fair trial). *Mezinárodní vztahy (International Relations)*. 2014, 49 (4), pp. 102–120. ISSN 0323-1844.

[10] Judgment of the Constitutional Court file No. (sp. zn.) II. ÚS 1658/11 - 1 of November 29, 2011 [accessed on 2021-10-5]. Available from: https://www.aspi.cz/products/lawText/

action was justified by unlawful interference with its right to protect the reputation of a legal entity and by violating its copyright and related rights. At the same time, ČEZ filed a motion for a preliminary measure against Greenpeace to remove the modified video from its Facebook pages and refrain from using it, which the Municipal Court in Prague upheld on the same day, but without stating any reasons for doing so (as foreseen by § 169 (2) of Act on the Civil Procedure). Greenpeace filed an appeal, which was rejected by the High Court in Prague which upheld the decision of the first court.

Greenpeace filed a constitutional complaint with the CC, challenging the failure to state reasons for the resolutions of both courts, thus establishing their unreview ability. The resolutions interfere with its right to freedom of expression under Article 17, (1), (2) of the Charter, and it is irrelevant whether its criticism of ČEZ is correct. The video was used under Greenpeace's legal license due to parodic criticism in the sense of § 38g Copyright Act, but the court intervened in this free discussion by completely silencing one party. The court held that ČEZ does not materially seek to protect copyright, but uses it to achieve other goals - the protection of the good name of a legal entity.

The CC ruled in favour of the complainant and annulled both contested resolutions violating the complainant's right to a fair trial under Article 36 (1) of the Charter as well as to freedom of expression under Article 17 (1), (2) of the Charter. If Greenpeace invoked the objection of parody as an expression of freedom of expression, which requires extensive evidence, which is precluded in the interlocutory proceedings, both ordinary courts should have carefully considered the need for its admission.[11]

The public should be acquainted with all available facts to provoke a well-founded debate in matters of societal interest and the subsequent formation of the opinion of individuals or to reach a consensus (see the older finding file no. II. ÚS 164/15).[12] He described the procedure of both courts as arbitrary and unconstitutional; the absence of proper justification would be permissible according to the meaning of § 169 of the Code of Civil Procedure. Only in the case of a "proposal to which no one objected", although they could realistically - if they would like to - oppose it, as the CC concluded in an earlier judgment, file number IV. ÚS 1554/08.[13]

[11] The legal exception for caricature and parody is a consequence of the right to freedom of expression, but must be within the limits set by the general three-stage test in § 29 of Czech Copyright Act (Article 9 of the Berne Convention) - EU "Information" Directive, which introduced this legal license borders of copyright and is easily abused, and therefore the Czech Republic projected it into the text of Copyright Act after a long time in 2017 - also GEIGER, Christophe. From Berne to National Law, via the Copyright Directive: The Dangerous Mutations of the Three-Step Test. *European Intellectual Property Review*, 2007, 29 (12), 486-491 ISSN: 0142-0461.

[12] See also BARTOŇ, M. *Freedom of speech: principles, guarantees, limits*. Prague: Leges, 2010, pp. 30, 384 pp., ISBN 978-80-87212-42-4.

[13] Analysed case - the Judgment of the Constitutional Court No. I. ÚS 3169/19 of 31 March 2020 [accessed on 2021-10-5]. Available from: https://www.aspi.cz/products/lawText/.

### 2.3. Copyright and the right to information – conflicting rights

The conflict between the two basic constitutional rights arose when the Ministry of Health refused to provide the applicant with legal information prepared for the ministry by an external law firm, due to the protection of the copyrights of third parties. The general administrative courts upheld this refusal. Based on the applicant's complaint, the Constitutional Court then resolved the conflict of two constitutional rights - to protect the results of creative intellectual activity under Article 34(1) of the Charter and the right to free access to information vis-à-vis obligated entities under Article 17 (1), (5) of the Charter.

According to the CC´s interpretation, it is necessary to guarantee wide access to information concerning the way of exercise of state authority, but at the same time consider the extent of its restriction and respond to disproportionate demands or even abuse of the law to gain an unjustified advantage, in extreme cases to impermissible interference with the rights of others.

The final decision of these considerations is interesting from our point of view - the CC annulled the decision of both administrative courts, but not because of interference with the right to information under Article 17, but the right to a fair trial under Article 36 (1), and (2) of the Charter as the general administrative courts did not sufficiently address the fulfilment of the conditions for refusing a request for information. The CC did not himself dare to state the overriding weight of the importance of protecting one of the conflicting rights over the other (of course, it would not be said by the CC in general, but only in the context of the case) and transferred their assessment back to the general administrative courts. The CC tasked them to look for the basis for arguments for these scales, in which they preferred copyright.[14]

### 2.4. Copyright and the right to a fair trial – conflicting rights

The protection of copyright and related rights was enforced in the given case by their collective administrator against the operator of a bicycle shop by ordering payment pursuant to Section 23 of the Copyright Act, Act No. 121/2000 Coll., as amended. The payment was for public disclosure of copyright works broadcast by radio using a technical device to receive broadcasts to customers in the store in the course of its business, without concluding a license agreement with the collective administrator. When the operator refused and the Regional Court in Hradec Králové confirmed the claim of the collective administrator in a subsequent dispute, the operator filed a constitutional complaint. The store owner refused the arguments that she operates such a facility in her establishment. Such

[14] Judgment of the Constitutional Court of 21 March 2017, Ref.: IV. ÚS 3208/16 - 1 [accessed on 2021-10-5]. Available from: https://www.aspi.cz/products/lawText/.

equipment was owned and operated by its employee on the premises but for employee´s personal use, which could not affect the business of the establishment selling bicycles and spare parts and did not bring any economic benefit to her business.

The constitutional complaint was directed against the procedure of the Regional Court in Hradec Králové, which did not deal with its stated defence and did not lead to proving the objected facts and did not substantiate its decision. The Regional Court did not take into account the earlier judgment of this court,[15] in which it cited a CJEU decision in terms of the notion of the public, which "according to the Court must be made up of an unspecified number of potential listeners and, in particular, a fairly large number of persons".[16] The complainant used this as an argument in the present dispute. However, it was so-called trivial, where an appeal is not admissible under § 202 (2) of the Code of Civil Procedure, and therefore the complainant, who did not agree with the judgment of the court of first instance, had to turn to the CC, which was thus de facto placed in the review role of the court of appeal.

The CC accepted the complainant's objection and set aside the impugned judgment of the General Court for violating the complainant's right to a fair trial under Article 36 (1) of the Charter by failing to duly substantiate her decision (and not to deal rationally with the arguments put forward by the parties).[17] Compared to the previous case, the SC resolved the conflict between the complainant's right to a fair trial and the right to protection of the results of creative intellectual activity under Article 34 (1) of the Charter, which was exercised by the collective administrator, and did not address the weight of the exclusive copyright limits with the concept of the public.

[15] Decision of the Regional Court in Hradec Králové No. 29 EC 28 / 2012-50 of 18 July 2013 [accessed on 2021-10-5]. Available from: https://www.aspi.cz/products/lawText/

[16] Judgment of the CJEU of 2 June 2005, Mediakabel, C-89/04, paragraph 30 [online - accessed on 2021-10-5] and another judgment of 14 July 2005, Lagardere Active Broadcast, C-192/04, paragraph 31 [online - accessed on 2021-10-5] and judgment of 7 December 2006, SGAE (Sociedad General de Autores y Editores de España v Rafael Hoteles SA), C-306/05, paragraphs 37 and 38 [online - accessed on 2021-10-5]. For more recent case law of the CJEU on the conflict of copyright with other rights see e.g. VAN DEURSEN, Stijen and Thom SNIJDERS. The Court of Justice at the Crossroads: Clarifying the Role for Fundamental Rights in the EU Copyright Framework. *International Review of Intellectual Property and Competition Law*, 2018, 49(9), 1080-1098. Available from DOI: 10.1007/s40319-018-0745-8, and VAN DEURSEN, Stijen and Thom SNIJDERS. The Road Not Taken - the CJEU Sheds Light on the Role of Fundamental Rights in the European Copyright Framework - a Case Note on the Pelham, Spiegel Online and Funke Medien Decisions. *International Review of Intellectual Property and Competition Law*, 2019, 50(9), 1176-1190. Available from DOI: 10.1007/s40319-019-00883-0.

[17] Judgment of the Constitutional Court file No. II. ÚS 3076/13 - 1 of 15 April 2014 [accessed on 2021-10-5]. Available from: https://www.aspi.cz/products/lawText/.

### 2.5. Copyright and the right of its infringer to a fair trial and the ruthless action of the collective administrator - conflict resolution

A similar problem also arose from the activity of the collective administrator INTERGRAM, which ordered its operator to make the payment in accordance with Art. 23 Copyright Act for the public use of copyright works through operation of a television set in a restaurant. The restaurant refused the payment on the grounds that the television was not connected to a satellite and was not used for public reception of television broadcasts, but only for private purposes, such as the projection of private recordings of a car club. The case was also resolved before the Regional Court in Hradec Králové, which ruled in favour of the collective administrator. The restaurant has lodged a complaint.

The CC stated that the collective administrator must proceed "with the care of a proper manager", which, however, is not very ruthless and harsh towards the users of the objects of protection. Placing a television set and watching programs in a restaurant can orient guests' interest in this business and thus increase the operator's profit. This "commercial" aspect must also be taken into account when assessing whether there is an obligation to conclude a license agreement. However, it must be demonstrated that the television equipment is operational and may in fact infringe copyright and related rights. It is important to conclude this reasoning of the Constitutional Court that from the mere existence of a serviceable television in a restaurant, it cannot yet be immediately deduced that a contract must be concluded with a collective administrator, or that there is unjust enrichment of the operator. In the given case, the CC annulled the decision of the court of first instance stating that the court did not examine these circumstances and thus violated the operator's constitutional right to a fair trial under Article 36(1) of the Charter and Article 6 (1) of the Convention for the Protection of Human Rights and Fundamental Freedoms.[18]

### 2.6. Application of criminal law protection of copyright only as an ultima ratio and the right to fair trial – conflicting rights

The CC assessed the filing of a complaint by the collective administrator to prosecute the restaurant operator for making intangible items protected by copyright law available to public through a television set in the restaurant without a license and without paying the fee as hurried prosecution. To stop violations of civil law, it is necessary to use primarily private law instruments, in case of their insufficient administrative sanctions and only in the last place as an ultima ratio

[18] Judgment of the Constitutional Court file No. II. ÚS 2186/14 - 1 of 13 January 2015 [accessed on 2021-10-5]. Available from: https://www.aspi.cz/products/lawText/.

criminal sanction. To do otherwise would be contrary to the principle of the subsidiarity of criminal repression, which requires the state to apply the means of criminal law with restraint.[19]

## 3. CONCLUSIONS FROM THE ANALYSIS OF CASES OF THE CONSTITUTIONAL COURT AND THE CONCEPT OF COPYRIGHT PROTECTION IN THE CONSTITUTIONAL LAW

### 3.1. Conclusions on the generalization of the approaches of the Constitutional Court of the Czech Republic to the resolution of conflicts of constitutional rights when considering the constitutional protection of copyright

From the above-mentioned decisions of the Constitutional Court when assessing the constitutional aspects of copyright protection, it is clear that these are rather isolated cases. It can be stated that the participants in court disputes turn to the Constitutional Court in the field of copyright with constitutional complaints less than to the Czech Supreme Court in a second appeal or to the CJEU in proceedings on a preliminary ruling in the EU law. Although we could not analyse here all decisions of the CC in this field due to the limited scope of the article, there are not many more in total and the selected cases can serve as an adequate sample.

The analysed cases concerned the copyright protection of the results of creative intellectual activity through the application of Article 34 (1) of the Charter. They did not deal with the other intangible assets which are not of a creative nature (some rights related to copyright) and are therefore protected only as general property under Article 11 of the Charter, or other provisions - as set out in point 1 of this paper.

The cases in which the parties to the disputes turned to the Constitutional Court with a constitutional complaint concerned wrongs in the court and other public authorities procedures (violation of the right to a fair trial, failure to refer a preliminary reference to the CJEU where it should have been made, arbitrary and reckless performance of collective administration), copyright protection used as an exception to the obligation to provide free access to information, inaction of a state body, assessment of the conditions to the right to criticism in the form of parody and protection of copyright works used in parody or attacked by parody, hasty use of criminal repression, etc.).

In these cases, the Constitutional Court often considered the conflict of copyright protection under Article 34(1) of the Charter against other constitutional rights, eg. freedom of expression and the right of free access to information

[19] Decision of the Constitutional Court of 12 October 2006, Ref.: I. ÚS 69/06 - 0 see ASPI | Wolters Kluwer ČR, a. s. [Accessed on 2021-10-5]. Available from: https://www.aspi.cz/products/lawText/.

under Article 17 of the Charter, the right to a fair trial under Art. 36, right to have their legal judge under Art. 38, etc. Considering importance of the right to protect the results of creative intellectual activity as well as its conflict with other constitutional rights, the CC did not decide which of the conflicting constitutional rights should take precedence over another one. As these deeper views and reasoning were generally omitted by the general or administrative courts whose decisions it assessed from the point of view of constitutionality, it annulled their decisions and always provided more detailed instructions on individual aspects, which these courts should discuss and verify more thoroughly, or it stated how other public authorities (ministries) and collective administrators had wronged in the present cases.

From the analysed cases it is evident that the CC stated several times the contradiction of a certain provision of the Act (on the Code of Civil Procedure), or its incorrect interpretation and application and interfered in the judicial activity of general and administrative courts, whose decisions it annulled for violation of the constitutional order. It is an important function of ensuring constitutionality in law and can also be observed in wrong legislation and decisions of public authorities issued during the Covid-19 pandemic - which these legislative and judicial bodies should have taken into account. Such a dichotomy of copyright and other rights, among which it is necessary to choose very judiciously, if there is no reckless preference, also appears in the binding of copyright in corporate law.[20]

### 3.2. Place and concept of copyright protection or intellectual property in the constitutional law of the Czech Republic, the EU, the USA and in international conventions

Copyright belongs to the broader traditional field of intellectual property rights, which also includes industrial property (in the first group the results of creative intellectual activity - inventions protected by patents, utility and industrial designs, topography of semiconductor products - chips, plant varieties and in the second group trademarks, designations of origin and geographical indications, trade names). Intangible assets protected by copyright law are not uniform in nature either - copyright works, including computer programs and database structure, and performances of performers (actors, musicians, singers, etc.) can be singled out, the conceptual definition of which includes the results of creative intellectual activity (as well as the first group of industrial property) and their constitutional protection is ensured by the special provision of Article 34 (1) of the Charter, as already mentioned. Other intangible objects protected by copyright (sound recordings, audio-visual recordings, radio and television programs,

[20] DRASSINOWER, Abraham. From Distribution to Dialogue: Remarks on the Concept of Balance in Copyright Law. *The Journal of Corporation Law*, 2009, 34 (4), pp. 991-1007, ISSN 0360-795X.

database content) and the second group of industrial property are not conceptually inherent in the results of creative intellectual activity and Article 34 (1) of the Charter can be applied to them only in a broader sense, together with the intangible assets of the first group, however, according to their nature, they are protected in the Charter primarily by Article 11 within the general protection of property.

Constitutional protection of intangible assets protected by copyright law in relation to their nature is fragmented under two articles of the Charter into two constitutional rights. From the point of view of the structure of constitutional rights in the Charter, the protection of the results of creative intellectual activity in Article 34(1) (i.e. the first group) belongs to economic, social and cultural rights - to the third general group of constitutional rights. As regards the right to a fair trial in Article 36 and the prohibition of deprivation of a statutory judge in Article 38, the application of which was often used by the CC in the analysed cases, the Charter responds to the principle of enforceability by modifying this additional group.[21] On the contrary, the protection of property in Article 11 in the structure of the Charter is one of the fundamental human rights and freedoms – of the first group of constitutional rights.

The question arises as to how the special constitutional right according to Article 34 (1) can be understood in relation to other constitutional rights (especially Article 11 and Article 10 and Article 15 of the more general first group of fundamental human rights and freedoms). And also, whether this Czech constitutional concept of special protection of intellectual creation is not too narrow. Whether intellectual property law would not have comprehensive protection under one common Article of the Charter. This would correspond to the concept of EU law, which in Article 17 (2) of the Charter of Fundamental Rights and Freedoms of the EU (hereinafter the EU Charter) states only a brief "intellectual property is protected", where it is not clear whose are these rights, what goods and under what conditions it is to be protected.[22] The EU Charter thus includes the constitutional protection of copyright, or of whole intellectual property in the framework of general protection of property as its unified subgroup, in contrast to the concept in the Czech Charter.

The concept of intellectual property in the EU Charter is close to the concept of Article 8 of the US Constitution, which, as Koukal states,[23] did not derive constitutional protection of intellectual property from the creator/inventor,

[21] KLIMA, Karel. *Constitutional comparative law*. Prague: Metropolitan University Prague Press, Wolters Kluwer ČR, 2020, pp. 111-112, 332 pp., ISBN 978-80-7598-883-6.

[22] KOUKAL, Pavel. *Copyright, public domain and human rights*. Brno: Masaryk University (MUNI PRESS), 2019, pp. 325-335, 524 pp., ISBN 978-80-2109279-2. Also, GEIGER, Christophe. Constitutionalising Intellectual Property Law? The Influence of Fundamentals Rights on Intellectual Property in Europe. In *International Review of Intellectual Property and Competition Law (IIC)*. 4/2006, p. 376. Electronic ISSN 2195-0237.

[23] KOUKAL, Pavel, *Copyright, public domain and human rights*. Brno: Masaryk University (MUNI PRESS), 2019, pp. 326-327, 524 pp., ISBN 978-80-2109279-2.

but only enshrined the Congress of the United States "to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries". The exclusive absolute rights of authors and other creators are not understood as their natural rights, arising from the creative activity and personality of the creator, but in the intentions of Thomas Jefferson as a reward for the new knowledge they have brought to society. Thus, protection in its (even in the current American) concept does not reflect the personality of the creator.[24]

The concept of Article 34 (1) of the Czech Charter is derived from the Czech Republic's obligation to abide by international human rights conventions within the meaning of Article 10 of the Czech Constitution, especially by the European Convention for the Protection of Human Rights and Fundamental Freedoms of the Council of Europe of 1950. On the contrary, the tendency of EU law is a departure from international conventions and "external control" by the activities of the European Court of Human Rights of the Council of Europe (Strasbourg) and the emphasis on the creation of the EU's own constitutional law in the EU Charter and the case law of the CJEU (Luxembourg).[25]

The nature and enshrinement of special protection in Article 34 of the Charter can be discussed. Telec considers it superfluous because its functions are generally performed in the Charter by Article 11 in the field of protection of property, and Article 10 in the field of protection of personality.[26] In the cited work, Koukal does not reject the special regulation of Article 34 and acknowledges the possibility of its independent application in some cases and in others as the intersection of other articles of the Charter (10, 11, 15 para. 2, 17 (2)) with their measurement in the mosaic principle. The research carried out by the author in this article confirmed this important function of Article 34 (1) and the approach of the CC, as well as the correctness of the understanding of intellectual property as one field.

## CONCLUSION

In the Introduction to this article, the author promised not only to make an overview of the activities of the Constitutional Court in assessing the constitutional protection of copyright - especially in conflict with other constitutional

[24] BRACHA, Oren. The Ideology of Authorship Revised: Authors, Markets, and Liberal Values in Early American Copyright. *Yale Law Journal*, 2008, 118 (2), 186-271, ISSN 0044-0094; 1939-8611.

[25] SVOBODOVÁ, Magdalena. *The process of accession of the European Union to the European Convention for the Protection of Human Rights and Fundamental Freedoms*. In KLIMA, Karel et al. *Public administration and human rights.* Prague: MUP Press, 2015, pp. 45, 255 pp., ISBN 978-80-87956-48-9

[26] TELEC, Ivo. *Overview of intellectual property law - Human rights foundations, license agreement*. 1 part. Brno: Doplnek, 2002, p. 72, ISBN: 80-7239-110-0

rights, but also to generalize the tendencies that can be traced in this activity of the CC. This was analysed in Part 2. In Part 3.1, the significance of the decision of the CC in specific cases was assessed, where the decisions of general and administrative courts as well as some provisions of laws are assessed in terms of conflict with the constitutional order. The paper has been proven the impact of the decision of the CC on legislation and its judicial and administrative interpretation. This should be emphasized especially with regard to the experience with cases of conflicts with the constitutional order, which appeared in the practice of Czech law and CC decisions during the Covid-19 pandemic. The analysed case law proved, how difficult it is to assess the conflict of constitutional rights, which was witnessed by some CC justices voicing their dissenting opinions.

In the part 3.1 of this paper, the results of the research of individual decisions of the CC were evaluated: it was found that the CC judges the constitutional protection of copyright relatively rarely and applies it mostly according to Article 34 (1) of the Charter. Thus, the CC measured by the principle of the mosaic the importance of individual constitutional rights, which came into conflict with the right to protection of the results of creative intellectual activity. However, it did not state which law has the application priority in the given case, it generally solved the problem with the help of the protection of the right to a fair trial according to Art. 36, or 38 of the Charter. In the analysed cases, the Constitutional Court effectively intervened in the decisions of general and administrative courts, which it annulled in the event of a conflict with the Charter and emphasized it in relation to legislation, similarly to the Covid-19 pandemic cases and legislation.

In the last part of this paper, the concept of constitutional protection of copyright in the Czech Republic was compared with the concepts in the EU Charter, the US Constitution and international conventions. From the results of the comparison it can be concluded that the concept of the Czech Charter with special protection of the results of creative intellectual activity will stand up and better allow to express the specifics of these intangible assets, even if institutional protection is not provided equally to the entire field of intellectual property.

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