Nicole Grmelová (ed.)

Perspectives of Law in Business and Finance

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Perspectives of Law in Business and Finance

Editor:

Nicole Grmelová

Activity

Nicole Grmelová is Associate Professor and Head of the Department of Business and European Law, Faculty of International Relations, Prague University of Economics and Business, Czech Republic. She graduated from Charles University Law School, Prague, Czech Republic, and from the Sevilla University Law School in Spain. She holds a Ph.D. degree in Business Law from the Prague University of Economics and Business. Between 2004 and 2008 she worked as an in-house lawyer-linguist for the European Parliament in Brussels. She also cooperated with the Court of Justice of the European Union as a lawyer-linguist under a framework agreement. Nicole Grmelová is the Czech Republic´s Country Correspondent to the European Food and Feed Law Review, and a member of the editorial board of the World Economy and Policy Journal. She publishes widely in international peer-reviewed journals.

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 international 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; e.g. a study 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. Most recently she published a paper on "The Unfair Trading Practices Directive Revisited" in the *European Food and Feed Law Review* (2022, Vol. 17, No. 4, pp. 300–305).

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 Compostela (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.

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Perspectives of Law in Business and Finance

Conference proceedings
14th International Scientific Conference "Law in Business of Selected Member States of the European Union"
November 3-4, 2022, Prague, Czech Republic

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Foreword

Dear Ladies and Gentlemen,

These conference proceedings constitute a selection of the best papers submitted to the 14th 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 3 and 4 November 2022 and welcomed speakers and participants from both Europe (Ireland, Germany, Croatia, Poland, Romania, Greece, Slovakia, and the Czech Republic) and overseas (South African Republic, India). The conference was held in a hybrid format, being streamed online for those who could not join the conference venue in person and to reach a wider audience. The selection of the papers for the conference volume was very rigorous. Out of 43 papers received from 16 countries, 31 papers from authors coming from 10 countries were admitted to the peer review. 14 papers were shortlisted for this conference volume, which means that the acceptance rate reached 45 per cent.

All papers were checked for their originality using the iThenticate software developed by Turnitin kindly provided by the Prague University of Economics and Business. The participant's papers were presented in specialized sections which correspond to the subheadings of the present volume:

- Business and Commercial Law
- Insolvency Law
- Competition Law
- Consumer Protection
- European and International Legal Aspects of Doing Business, and
- Banking, Finance, and Insurance Law

Unlike the conference events held in the past years, this conference has grown much more sustainable. Plastic water bottles were replaced by glass packaging, hence no plastic was produced during the entire conference event.

The conference has been supported by the Internal Grant Agency Project No. F2/44/2022 "Law in Business of Selected Member States of the European Union (14th annual conference)" of the Prague University of Economics and Business.

The Chair of the Scientific Committee would like to appreciate the invaluable assistance provided by the Members of the Organizational Committee, in particular Regina Yusupova for anonymising the papers prior to the peer review and for processing the peer review and Lukáš Bumbálek for compiling the conference programme, and formatting the papers following the peer review.

The conference organizers will be happy to welcome both international academics and practitioners **to the 15th conference** to be held next year between **26**

and 27 October 2023 in Prague. For more information on the call for papers for the upcoming conference please check the conference webpage at https://law-inbusiness.vse.cz/.

Nicole Grmelová
Chair of the Scientific Committee

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SECTION I
BUSINESS AND COMMERCIAL LAW

Business Activities conducted by the Czech Roman Catholic Church following the restitution of property confiscated under the Communist Regime

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Abstract: *The Roman Catholic Church has restituted property which has been nationalized under the Communist Regime. The restitution process paves the way for a separation between the state and the church in the foreseeable future. Thus, the Roman Catholic Church will have to invest the restituted property wisely to be able to cover the costs of its main activity, the spiritual care of its followers. Having analysed the business model of current activities of the Roman Catholic Church, this paper argues that the centralized top-down approach adopted by the Roman Catholic Church may not be efficient enough for the Roman Catholic Church to achieve economic self-sufficiency in the long run. The objective of this paper is to assess if the current economic activities conducted by the Roman Catholic Church in the Czech Republic can lead to its economic self-sufficiency by 2030. To this end, the authors will interpret the restitution model as determined by the corresponding legal rules and analyse the data covering the business activities of the Roman Catholic Church.*

Keywords: *Business Activities, Czech Republic, Property Restitution, Roman Catholic Church, Self-sufficiency.*

INTRODUCTION

The objective of this paper is to assess if the current economic activities conducted by the Roman Catholic Church in the Czech Republic can lead to its economic self-sufficiency by 2030. To this end, the authors will interpret the restitution model as determined by the corresponding legal rules and analyse the data covering the business activities of the Roman Catholic Church.

Under the 2012 Restitution Act[1], the Czech Roman Catholic Church has received a combination of natural and monetary restitution of property confiscated under the Communist regime. Natural restitution was possible where former Roman Catholic Church property was owned by the state. However, where this property was owned by non-state entities (such as municipalities and private individuals) monetary compensation was agreed upon to be paid up in annual instalments over a period of 30 years. Under the 2012 Restitution Act the state will stop funding the salaries of the clergy in 2030, by which date the Roman Catholic Church should be able to generate its own income to cover these expenses.

There are no consolidated data available on the business activities conducted by the Roman Catholic Church in the Czech Republic as there are no consolidated financial statements available. Representatives of the Roman Catholic Church of the Czech Republic are rather reluctant to disclose detailed information about how business-related decisions are being taken and what business decision are being taken. Thus, the authors had to rely mainly on data provided by the individual archbishoprics, and the media. Some economic data have also been retrieved from public databases, such as the Commercial Register which keeps records of the annual reports of businesses run by different entities pertaining to the Roman Catholic Church and from the state budget.

The paper sets out with a brief outline of the restitution process to continue with an overview of possible Church funding resources and subsequently analyses the business activities conducted by the Roman Catholic Church so far. In conclusion, it summarizes the outcomes of the analyses and makes suggestions on how the Roman Catholic Church may proceed in future in terms of raising funds for its main task, the spiritual care of its followers.

1. OUTLINE OF THE RESTITUTION PROCESS

The Roman Catholic Church lost a significant part of its property under the First Czechoslovak Republic (1918-1938) as well as under the Communist

[1] CZECH REPUBLIC Act No. 428/2012 Coll., on Property Settlement with Churches and Religious Societies [zákon č. 428/2012 Sb., zákon o majetkovém vyrovnání s církvemi a náboženskými společnostmi].

Regime. Legislation adopted after the Velvet revolution tried to remedy the illegal seizure of religious property which occurred between 1948 and 1989. In 1990 the Act on the adjustment of certain property relations of religious orders and congregations[2] was adopted[3]. Under this Act 57 property items were returned to the religious orders and congregations. Under another 1991 Act[4], other 113 buildings were returned by the state to provide for further existence and development of religious orders. In the period between 1990 and 1991 a total of 170 dilapidated monasteries were returned to the church. While this act contained a promise to return church property, the restoration of property to churches and religious societies was not definitively resolved, leaving to the state a vital share in funding the activities of churches and religious societies, including the provision of clergy salaries[5]. Since Czechoslovakia split into two independent republics in 1993, the final settlement for property confiscated within the territory of the Czech Republic with the church had to be adopted by the new successor state.

Finally, in 2012 the Act No. 428/2012 Coll. on the property settlement with churches and religious societies was adopted. However, it was only passed by a narrow vote in the lower legislative chamber, having received 93 votes in favour and 89 against[6]. After being approved by the Czech Senate, the act came into force on January 1, 2013. This piece of legislation finally paved the way for the separation between the state and the Church in the Czech Republic and took much longer to adopt than in any other neighbouring country resolving similar post-Communist issues[7]. The lagging behind Poland, Slovakia[8] and Hungary can be justified at least by two different reasons. First, the weak political standing of the Catholic People´s Party in the Parliament triggered a lack of political will (especially on the part of the left-wing politicians) to hand over the confiscated property to the Catholic Church. Second, there is a much lower church affiliation of Czechs in general compared to the neighbouring countries.

Under the Act No. 428/2012 Coll. on the property settlement with

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[2] CZECHOSLOVAK FEDERAL PARLIAMENT Act No. 298/1990 Coll. [zákon Federálního shromáždění ČSFR č. 298/1990 Sb., zákon o úpravě některých majetkových vztahů řeholních řádů a kongregací a arcibiskupství olomouckého]

[3] CZECH GOVERNMENT. Explanatory Statement to the Church Restitutions Act, 2012 (in Czech).

[4] CZECHOSLOVAK FEDERAL PARLIAMENT Act No. 338/1991 Coll., amending the Act No. 298/1990 Coll. [zákon Federálního shromáždění ČSFR č. 338/1991 Sb., kterým se mění a doplňuje zákon č. 298/1990 Sb.]

[5] VALEŠ, Václav. *Restituce církevního majetku v České republice po roce 1989*. Brno: Moravskoslezská křesťanská akademie. 2009, 101, 978-80-904075-1-0.

[6] KOLÁŘ, Petr. *Vybrané aspekty projednávání legislativních návrhů dotýkajících se problematiky církevních restitucí v České republice. Studie č. 5.343*. Praha: Parlamentní institut[online]. 2014. [viewed 12 August 2022]. Available from https://www.psp.cz/sqw/text/orig2.sqw?idd=97311.

[7] MINÁRIK, Pavol. Church-State Separation and Church Property Restitution in the Czech Republic. *Society. 2017* (54), 459–465.

[8] For issues relating to funding churches in Slovakia see e.g. TURČAN, Martin and Michal MRVA. K problému ukončenia financovania cirkví štátom. *Revue církevního práva.* 2021, 85(4), 71-85.

churches and religious societies, churches were to be returned assets worth about CZK 75 billion (an equivalent of about EUR 2.88 billion) and to be gradually paid about CZK 59 billion (before taking inflation into account) over the period of 30 years (an equivalent of about EUR 2.26 billion) as a compensation for confiscated assets[9]. The monetary compensation to be received by the Roman Catholic Church amounts to CZK 47.2 billion (an equivalent of EUR 1.89 billion). The combination of returning property in kind and of making a gradual payment of financial compensation resulted from the fact that some property which originally belonged to the Catholic Church was no longer in state ownership and only state property could be handed out.

Concerning the timing to implement the restitution of property, transitional periods were established. The property settlement in kind will be completed by 2030, and the payment of the annual compensation to churches will end in 2040[10]. Under the Act No. 428/2012 Coll., on property settlements with churches and religious societies, the Roman Catholic Church was earmarked to receive 80% of the financial compensation, while the remaining churches received 20% of the financial compensation[11]. Before assessing the funding design developed by the 2012 Church Restitution Act, the current model of providing funds to the churches will be addressed.

2. CURRENT FUNDING OF THE CHURCHES IN THE CZECH REPUBLIC

The current regulatory framework of funding churches and religious societies is enshrined in Article 27 Act No. 3/2002 Coll. on Churches and Religious Societies. Under this provision, the main sources of income of churches registered with the Czech Ministry of Culture include:

- Contributions made by natural persons and legal entities;
- Income generated by sales or lease of movable assets and real estate belonging to the churches and religious societies;
- Interest on deposits,
- Donations and heritage,
- Collections,
- Loans and credits,
- Income generated by business activities,
- Grants and subsidies to maintain historical buildings which are part of the state heritage.

[9] CZECH GOVERNMENT. Explanatory Statement to the Church Restitions Act, 2012 (in Czech).
[10] GRMELOVÁ, Nicole. The Catholic Church as an Entrepreneur in the Czech Republic. In: ŠKRABKA, Jan, VACUŠKA, Lukáš (ed.). *Právo v podnikání vybraných členských států Evropské unie. Sborník příspěvků k XII. ročníku mezinárodní vědecké konference*. Praha: TROAS, s.r.o, 2020, 79–86, 978-80-88055-10-5.
[11] CZECH GOVERNMENT. Explanatory Statement to the Church Restitions Act, 2012 (in Czech).

Under Article 17 Church Restitutions Act the state will continue to pay the churches a contribution for their functioning (operative costs) during a transitional period which will expire in 2030. Starting from 2014 the annual state contribution will be reduced by 5 per cent compared to the first year of the transitional period (2013). The state contribution is not subject to tax.

Tab 1. Breakdown of the state funds transferred by the Ministry of Culture to the Roman Catholic Church between 2018 and 2020

Year	Operative costs (salaries of clergy, maintenance of church buildings)	Monetary compensation under the Act on Church Restitutions	Total in CZK	Total in EUR (approximately)
2020	713 599 500	1 748 931 276	2 462 530 776	98 501 231
2019	761 172 800	1 712 959 134	2 474 131 934	98 965 277
2018	808 746 100	1 671 179 643	2 479 925 743	99 197 030

Source: Own compilation based on data available at the website of the Czech Ministry of Culture 2021

Special provisions apply to the funding of Church run schools. As of 2019 the Roman Catholic Church operated 62 schools ranging from pre-schools to secondary schools run by dioceses or parishes. Roman Catholic religious orders and congregations operate 39 more educational facilities. It total, there are 101 educational entities run by the Roman Catholic Church in the Czech Republic. In 2019 these schools were attended by more than 16.700 students and instructed by 1.655 teachers[12].

The subsidies to Church run schools are based on Article 160 of the Act on Schools, which uses as the main criterion for funding the number of children, pupils or students. This monetary contribution made by the state can be used to cover the salaries and costs resulting from labor relationships (including the costs of social security and health insurance) as well as educational tools (such as textbooks).

3. ASSESSMENT OF THE RESTITUTION MODEL

Whereas the lay public believes that the state has "overpaid" the Roman Catholic Church by the restitution model and the Communist Party even attempted to have the restitutions subjected to a tax[13], which was strongly opposed

[12] CZECH BISCHOPS´ CONFERENCE. *Život katolické církve v datech a faktech* [Online]. 2020. [viewed 12 August 2022]. Available from: https://www.cirkev.cz/cs/aktuality/201120publikace-zivot-katolicke-cirkve-v-datech-a-faktech.

[13] KUDRNA, Jan. *Je zdanění církevních restitucí (ne)ústavní?* [Online]. 2018. [viewed 12 August 2022]. Available from: https://pravniradce.ihned.cz/c1-66073920-pravo-ocima-jana-kudrny.; NO-

by the Church (Czech Bishops´ Conference, 2018) an insider view reveals that the opposite may be the case as noted by the former chief economist of the Prague Archbishopric, Roman Češka. Češka says that the Church has been at least two and a half times damaged by the fact that its property has not been handed over for 20 years. All the other restitution beneficiaries had those wrongs remedied by the early 1990s. The Church only 20 years later, which is a big economic difference. The state admitted I did cause damage to the church and would compensate it with a lump sum. However, this sum would not be paid in one instalment, but over a period of 30 years. In economic terms, it makes if big difference between getting a million right away or getting 33 thousand every year. If the church receives 33 thousand Czech crowns every year for 30 years, it cannot invest them reasonably. The church has agreed to a situation where what it could buy for a million Czech crowns ten years ago would costs 10 times as much 30 years later. An inflation clause slightly raises the annual instalments but that does not reflect the real increase in prices in the markets[14]. Also, the Olomouc Archbishopric shares the view that the property restitution has by no means been exaggerated[15].

4. BUSINESS ACTIVITIES CONDUCTED BY THE ROMAN CATHOLIC CHURCH

The monetary contribution received by the Roman Catholic Church should be invested in a sustainable manner to replace the state payments for the salaries of the clergy which are being reduced every year and will be discontinued in 2030. So far, the investments made by the two archbishoprics in the Czech Republic (the Prague archbishopric covering the area of Bohemia and the Olomouc archbishopric covering the area of Moravia and Silesia) have not managed to compensate the reduced annual sum for salaries of clergy. The average return on investment amounting to some 4 per cent does not even compensate for the current inflation rate[16] which has exceeded 10 per cent in the first months of

VOTNÁ Dominika. Zdanění církevních restitucí ve světle zásady pact sunt servanda, *Bulletin advokacie*. 2019(12), 26-30, and PERGLER, Tomáš. Zdanění restitucí je hanba politiků, katolická církev ale doplatí hlavně na jejich formu. Z podnikání se neuživí, musí se obrátit na věřící, říká Roman Češka, *Hospodářské noviny.* [online] 2019. [viewed 12 August 2022]. Available from: https://domaci.hn.cz/c1-66517360-zdaneni-restituci-je-hanba-politiku-katolicka-cirkev-ale-doplati-hlavne-na-jejich-formu-z-podnikani-se-neuzivi-musi-se-obratit-na-verici-rika-roman.

[14] CZECH PUBLIC RADIO CHANNEL Český rozhlas Plus. *O finanční rozvaze církví debatují Roman Češka a Jiří Schneider* [online] 2021. [viewed 12 August 2022]. Available from: https://plus.rozhlas.cz/restituce-a-nahrady-cirkvim-nestaci-farnici-meli-prispivat-vice-i-do-kasicek-8533973/2.

[15] OLOMOUC ARCHBISHOPRIC (2018) *Přemrštěná finanční náhrada? Spíš velkorysost církve* [online]. 2018. [viewed 12 August 2022]. Available from: https://www.ado.cz/2018/10/02/premrstena-financni-nahrada-spis-velkorysost-cirkve/.

[16] CZECH PUBLIC RADIO CHANNEL Český rozhlas Plus. *O finanční rozvaze církví debatují Roman Češka a Jiří Schneider* [online] 2021. [viewed 12 August 2022]. Available from: https://

2022[17].

The Roman Catholic Church has adopted a top-down approach in term of its business and investment strategy. Yet, those making economic decisions of a large scale may not be aware of the local peculiarities of the individual parishes and their needs. The opposite bottom-up approach adopted by other denominations in the Czech Republic seems more efficient insofar as local communities master the local needs and are willing to support projects which further enhance the spiritual live of the local community. Small projects, such as the establishment of a small religious school may not generate immediate profit, yet they will strengthen the local religious community which is likely to thrive in the future. If the Roman Catholic Church spends too much time administering its property, it will miss the opportunity to work closely with local communities and may end up losing their interest and support altogether. The most recent national census held in 2021[18] shows that fewer inhabitants of the Czech Republic formally declared their affiliation to the Roman Catholic Church (741 thousand) compared to the 2001 census: 2.7 million inhabitants[19]. Projects run by the Roman Catholic Church at local levels are marginal with respect to big property investments made centrally.

To examine the business plan of the Roman Catholic Church in further detail, the authors have distinguished different industries of the activities, ranging from forestry and agriculture, investments into real estate to capital investments.

4.1. Forestry and agriculture

The Archbishopric of Olomouc is the largest non-state owner of forests in the Czech Republic[20]. The limited liability company administering the forests (Arcibiskupské lesy a statky Olomouc s.r.o.) was established in 2013 and takes care of more than 42 thousand hectares of forest land. The main tasks of the company administering church forests is achieving their sustainable management where logging should be compensated by replanting new trees. This company has developed its own saw processing. This favours local sale of logged wood and prevents its transport for further processing before sale. The forest company also

plus.rozhlas.cz/restituce-a-nahrady-cirkvim-nestaci-farnici-meli-prispivat-vice-i-do-kasicek-8533973/2.

[17] CZECH NATIONAL BANK. *Prognóza ČNB – jaro 2022.* [online]. 2022. [viewed 12 August 2022] Available from: https://www.cnb.cz/cs/menova-politika/prognoza/.

[18] CZECH STATISTICAL OFFICE. *First results of the 2021 census* [Online]. 2021. [viewed 12 August 2022]. Available from: https://www.czso.cz/csu/scitani2021/prvni-vysledky-scitani-2021-v-otevrenych-datech.

[19] CZECH STATISTICAL OFFICE. *Data on affiliation of the Czech population to churches* [online]. 2001. [viewed 12 August 2022]. Available from: https://www.czso.cz/csu/czso/ nabozenske_vyznani_obyvatelstva_ceske_republiky_23_12_04.

[20] FORESTS OF THE CZECH REPUBLIC STATE ENTERPRISE. *2019 Activity Report* [online]. 2020. [viewed 12 August 2022]. Available from: https://lesycr.cz/wp-content/uploads/2020/08/Lesy-%C4%8CR-Zpr%C3%A1va-o-%C4%8Dinnosti-v-roce-2019.pdf.

started selling game, firewood, and it rents hunting huts to the public.

Except for administering forests, the Olomouc Archbishopric is not considered an important competitor[21] in the field of its economic activities. As the area of forests returned to the Olomouc Archbishopric is very extensive, it has successfully managed to challenge the pre-existing monopoly of the state forests[22].

In contrast, the Archbishopric of Prague is a much smaller forest owner. The Archbishopric of Prague manages the forests directly through its organizational unit, the Forest Administration. In 2020, the Forest Administration of the Archbishopric of Prague managed 14,202 hectares of forests in the possession of this archbishopric. In 2020, the Forest Administration planted 232 hectares of forests using almost 900,000 pieces of tree seedlings[23]. The Forest Administration is aware of the obligation to take proper care of forests, which is also reflected in the declared goals of forest management it administers. These are based on the general objectives of Czech forestry, which include mainly sustainable forest management, efforts to balance the ecological, economic, and social dimensions of forest management, prioritizing nature-friendly management, and keeping harmful factors under control[24]. In addition to logging, the Forest Administration is involved in revitalization projects, such as creating a nine-hectare habitat in the Blatno forest in Krušné hory mountains (Erzgebirge) serving mainly as a habitat for rare species of birds, namely black grouses[25].

To emphasize its drive for sustainability, the Forest Administration of the Archbishopric of Prague has been granted both a PEFC certification (Program for the Endorsement of Forest Certification) and the FSC certification (Forest Stewardship Council)[26] which guarantee environmentally responsible, socially beneficial, and economically viable forest management[27]. The forest industry has

[21] BOHÁČEK, Martin. Výkon veřejné moci a její odpovědnost v oblasti práva hospodářské soutěže – specifika oboru nebo její nový model obecně? In: KLÍMA, Karel, et al. (eds.) *Odpovědnost veřejné moci*. Praha: Metropolitan University Prague Press, 2013, pp. 279–305. 356 p. ISBN 978-80-86855-94-3.

[22] ŠAFAŘÍK, Dalibor, HLAVÁČKOVÁ, Petra, and David. BŘEZINA (eds.). *Stability of the Forest and Wood Processing Sector in the Czech Republic.* Global Scientific Conference on Management and Economics in Manufacturing. Conference Proceedings. Zvolen: Technical University. 2017, 238-243; JARSKÝ, Vilém et al. Restitution of forest property in the Czech Republic and Slovakia – common beginnings with different outcomes? *Central European Forestry Journal*, 2018(64), 195-206.

[23] PRAGUE ARCHBISHOPRIC. *2020 Annual Report.* [online]. 2021 [viewed 12 August 2022]. Available from: https://apha.cz/wp-content/uploads/2021/09/ap-vz-2020-web-celek.pdf.

[24] PRAGUE ARCHBISHOPRIC FOREST ADMINISTRATION. *Lesní správa* [online]. 2021. [viewed 12 August 2022]. Available from: https://apha.cz/hospodareni-a-rozvoj/lesni-sprava/.

[25] PEFC. *Představujeme lesní správu arcibiskuptství pražského* [online]. 2021. [viewed 12 August 2022].Available from: https://www.pefc.cz/predstavujeme-lesni-spravu-arcibiskupstvi-prazskeho/.

[26] PRAGUE ARCHBISHOPRIC FOREST ADMINISTRATION. *Lesní správa* [online]. 2021. [viewed 12 August 2022]. Available from: https://apha.cz/hospodareni-a-rozvoj/lesni-sprava/.

[27] CZECH FSC. *About FSC International* [online]. 2021. [viewed 12 August 2022] Available from: https://www.czechfsc.cz/cz-cs/o-fsc-international.

largely contributed to improving the economic profits generated by the Roman Catholic Church in 2021. Prices of logged wood were very low before the covid-19 pandemic due to calamity logging caused by the overpopulation of the bark beetle. The Roman Catholic Church qualified for state subsidies of forest owners to compensate for the bark beetle damages in 2020, however, no full compensation was provided by the state. The Administration of the Roman Catholic forests administered by the Archbishopric of Olomouc estimates that the 2020 state subsidies covered only some 9 per cent of the entire damage caused by the bark beetle[28]. The forest economy has largely recovered due to rising prices of logged wood in 2021 and 2022[29]. Even though the Church forests managed to generate good profit selling logged wood in 2021 and continue to do so in 2022, if wood was not sold as a raw material, but as a semi-product with a higher added value, even more profits could be generated in the future.

In terms of agriculture, the establishment of new businesses (such as farms on fields which have been returned to the Roman Catholic Church) is insignificant in terms of their turnover. To give some specific examples, the following table summarizes the economic loss or modest profit generated by several farms run by the Olomouc Archbishopric:

Tab. 2 Economic results of the farms run by the Olomouc Archbishopric

Name of the farm	Year 2019	Year 2020
Chropyně Farm ("Statek Chropyně")	Economic loss despite state agricultural subsidies	Economic loss despite state agricultural subsidies
Bílčice Farm ("Farma Bílčice")	CZK 3.531 million	Economic loss
Moravian Beroun Farm ("Farma Moravský Beroun")	Economic loss	Economic loss

Source: Own compilation based on data in the Czech Commercial Register (Czech Commercial Register, 2022).

4.2. Investments into real estate

Many churches and other buildings returned to the Roman Catholic Church are almost falling apart particularly in areas with very few or no church goers, where local communities interested in resurrecting Catholic communities are missing. Investing into these buildings makes little sense as the associated

[28] RŮŽKOVÁ, Marie, and Jana DIVIŠOVÁ. Kůrovcové kompenzace 2020 jsou nedostatečné, změna způsobu financování lesnictví je nevyhnutelná. *Informační časopis společnosti ALSOL*, [online]. 2022(1)26. [viewed 12 August 2022] Available from: https://alsol.cz/images/casopis/2022_1_casopis_alsol_online.pdf.

[29] MIKEL, Jakub. Katolická církev i přes pandemii hospodařila nejlépe za poslední roky. Vydělala o 300 milionů více než předloni, *Hospodářské noviny [online]* 2021. [viewed 12 August 2022]. Available from https://archiv.hn.cz/c1-66991270-katolicka-cirkev-i-pres-pandemii-hospodarila-nejlepe-za-posledni-roky-vydelala-o-300-milionu-vice-nez-predloni.

costs would highly outnumber the possible benefits. Since the Roman Catholic Church cannot act as a National Heritage Trust, it would be advised to sell or donate those buildings to local communities to see if they can make a better use of them. In sever occasions, however, the Roman Catholic Church has already made vast investments into real estate which have been disproportionate to the expected gains. For instance, the Prague Archbishopric has converted a ruin of a chateau in Dolní Břežany (Central Bohemia) into a luxurious hotel, the rent of which can hardly recover the costs of its refurbishment even in the long run[30]. It appears that the Roman Catholic Church needed to make such an experience to start considering that substituting the role of the state as a National Heritage Trust is not the best way to achieve economic self-sufficiency. An interesting investment into real estate was made by the Brno bishopric, who bought the Špalíček shopping mall in this Moravian city, party using its own funds, party relying on a credit it received from a bank. The Brno bishopric will use the regular incomes from rents generated by the shopping mall to pay up its instalments of the credit. Economically, this project seems to be very reasonable, however, some followers of the Roman Catholic Church have criticized this project as running against the spirit of the activities the Church as running a shopping mall implies the support of consumption rather than the support of religious contemplation[31].

4.3. Capital Investments

The clergy serving the Roman Catholic Church are usually not well trained to administer property[32]. Investments made at professional level require a lot of specific knowledge and experience. Also, the Roman Catholic Church imposes certain restrictions on industries where it is not willing to invest such as armament industry, and lotteries (even though the possible profits generated in these fields could be significantly higher compared to other, more conservative industries). Thus, its capital investments can be labelled as ethical. In terms of capital investment, the Roman Catholic Church placed a part of its resources into the Sustainability Fund of the Roman Catholic Church in the Czech Republic operated by a subsidiary of the Belgian KBC bank in the Czech Republic (ČSOB). Another similar fund where the Roman Catholic Church deposited part of its funds is run by the Česká spořitelna bank, which is a subsidiarity of an

[30] NOVOTNÝ, Jan. Trampoty pana arcibiskupa. Pražská diecéze prodělává desítky milionů korun [online]. *Euro*. 2020. [viewed 12 August 2022]. Available from: https://www.euro.cz/byznys/trampoty-pana-arcibiskupa-prazska-dieceze-prodelava-desitky-milionu-korunČeška.

[31] ŠTAMPACH, Ivan. Brněnský Špalíček a jiné církevní investiční operace. *Deník Referendum* [online]. 2021. [viewed 12 August 2022]. Available from: https://denikreferendum.cz/clanek/32332-brnensky-spalicek-a-jine-cirkevni-investicni-operace.

[32] VOPÁLENSKÁ, Lucie. Restituce a náhrady církvím nestačí, farníci by měli přispívat více i do kasiček, navrhuje ekonom Češka. Czech Plus Radio Channel [online]. 2021. [viewed 24 October 2022]. Available from https://plus.rozhlas.cz/restituce-a-nahrady-cirkvim-nestaci-farnici-meli-prispivat-vice-i-do-kasicek-8533973.

Austrian mother bank. The riskiest capital investment made by the Olomouc Archbishopric so far was placing a share of its funds into the Czecho-Slovak Investment Group Arca Capital CEE against which bankruptcy was declared in May 2021 both in Slovakia and in the Czech Republic[33].

5. BALANCING THE CHURCH´S INCOME AND EXPENDITURES

The income of the Roman Catholic Church in 2020 can be compared with its expenditures during the same year. In the summer of 2021, The Czech Bishops´ Conference published its 2021 Report on the activities it conducted in 2020. In this Report[34] it summarized its expenditures based on the Church´s activities covering the period of 2020. Data for 2022 have not been released at the time of writing.

In 2020 the total expenditure of the Roman Catholic Church on pastoral and public services (such as running hospitals and schools) amounted to CZK 3.3 billion, remaining comparable to previous years. Nevertheless, despite the crisis year marked by the covid-19 pandemic, the dioceses made a **profit of CZK 376 million** which is CZK 347 million more than in 2019[35], mainly due to the appreciation of investments made in previous years. The dioceses of the Roman Catholic Church have traditionally invested significant resources in public services, in particular CZK 2.3 billion in 2020, only CZK 99 million less than in 2019. The costliest projects were the long-term repairs of monuments, which accounted for CZK 1.4 billion in 2020. **CZK 720 million was earmarked for pastoral activities**, which include weddings, funerals, baptisms, spiritual assistance, or work in hospitals. Another almost a quarter of a billion Czech crowns was used for health and social care, education, and cultural activities. **Less than a billion crowns were spent by the dioceses on staff salaries, including priests**, who were often available 24 hours a day during the covid-19 pandemic. According to the Czech Bishops' Conference, one of the activities that required a lot of energy and money last year was education. Investment in education rose by a quarter to CZK 132 million[36].

The process of the financial independence of the Church from the State, which will take place in 2030, continued in 2020. In 2020, the dioceses invested

[33] CZECH MINISTRY OF JUSTICE. Insolvency Register [Online]. 2022. [viewed 12 August 2022]. Available from: https://isir.justice.cz/isir/common/index.do.
[34] CZECH BISHOPS´ CONFERENCE. *Život katolické církve v datech a faktech* [Online]. 2020. [viewed 12 August 2022]. Available from: https://www.cirkev.cz/cs/aktuality/201120publikace-zivot-katolicke-cirkve-v-datech-a-faktech.
[35] CZECH PUBLIC TV CHANNEL. *Příjmy katolické církve meziročně klesly, hospodařila ale se ziskem. Pomohly dřívější investice* [online]. 2020. [viewed 12 August 2022]. Available from: https://ct24.ceskatelevize.cz/domaci/3391110-prijmy-katolicke-cirkve-mezirocne-klesly-hospodarila-ale-se-ziskem-pomohly-drivejsi.
[36] *Ibidem.*

846 million crowns in real estate and management supporting regional development (agriculture and forestry) and another billion crowns in ethical financial instruments, mostly through their two funds managed by Czechoslovak Business Bank (ČSOB) and Česká spořitelna. The total cost of all the Church's activities, including salaries for employees of the Roman Catholic Church, exceeds CZK 7 billion annually[37].

The Church will be able to continue receiving state subsidies for running schools, hospitals and reconstructing certain buildings even after the expiry of the transition period leading to the separation between the state and the church. However, the state will no longer cover the expenditures related to providing pastoral services and covering the salaries of priests and other church employees. In 2020 these expenses for pastoral services and salaries amounted to about one and a half billion CZK whereas the income generated by the business activities of the Roman Catholic Church CZK 376 million only. To be able to cover its pastoral activities and the salaries of the clergy, the Roman Catholic Church would need to generate many more funds. The ratio of CZK one and a half billion of expenditures to CZK 376 million income for 2020 looks rather unfavourable to easily continue providing pastoral services in the future, once the separation between the state and the Church has been completed.

6. POSSIBILITY OF ACTING ON FOREIGN MODELS OF FUNDING CHURCHES

The Roman Catholic Church should conduct its business activities to be able to sustain its pastoral services. Hence, no special tax treatment or contributions towards the salaries of the clergy have been foreseen in the Czech Republic once the transitional periods have expired. This model is not entirely typical for Europe. Francis Messner edited a volume in which different models of public funding of churches in Europe have been identified with a specific focus on the United Kingdom, France, Belgium, Germany, Italy, The Netherlands, Spain, and Turkey[38]. This volume has been drafted as an output of a project funded by the EU[39]. Taking inspiration from foreign models does not seem to be an accurate

[37] ERBEN, David. Pandemie připravila katolickou církev o stovky milionů. *Finanční a ekonomické informace* [online]. 2021. [viewed 12 August 2022]. Available from: https://faei.cz/pandemie-pripravila-katolickou-cirkev-o-stovky-milionu/.

[38] MESSNER, Francis (ed.) *Public Funding of Religions in Europe*. London: Routledge. 2020. 978-036759986-7. For more comparative analyses of church funding see also BOTELHO MONIZ, Jorge. European secularism: analysis of the funding mechanisms of churches and religious denominations in six European countries. *Revista Direito GV*. 2017, 13(3), 921-948, covering Austria, Italy, Poland, Portugal, Slovakia, and Spain.

[39] FOBLETS, Marie-Claire, and Katie ALIDADI. *Summary Report on the RELIGARE Project for the European Commission* [online]. 2013. [viewed 12 August 2022]. Available from: https://cordis.europa.eu/docs/results/244635/final1-religare-final-publishable-report-nov-2013-word-version.pdf.

procedure to follow as each state model mirrors the specific historical developments between the state and the church where a common denominator can be difficult to come by. Many religious funding models are based on a special tax treatment by way of a church tax (Germany), tax exemptions and/or tax reductions for specific purposes, such as in Belgium, France, Italy, and Spain. Other avenues of state funding of religions include project funding, state support for the protection of cultural and religious heritage, state (co-)funding of airtime earmarked for religious groups in the publicly owned TV and radio channels[40]. Whereas there is no tradition of a church tax or special tax treatment of religions in the Czech Republic, the Roman Catholic Church has been allocated airtime in the publicly owned TV channel and it has benefited from project-based subsidies, particularly with respect to maintaining building which are part of the national heritage. Before the Communist regime, the Roman Catholic Church was an established entrepreneur in the area of the forest industry, it rented out soil and buildings, and received more donations[41] from the churchgoers that it can possible collect nowadays due to a declining number of individuals attending services on a regular basis. The restitution model follows up the tradition of the pre-Communist era, where the Roman Catholic Church had to rely on its own funding rather on a third-party funding for its existence.

CONCLUSION

Whereas the public perception of the church restitutions is that the Roman Catholic Church has received too much to compensate the Communist confiscations, in fact, the state and the structure of the returned property and the compensation model makes it difficult for the Roman Catholic Church to achieve economic self-sufficiency in the foreseeable future. To replace the state payments of the salaries of the clergy and to cover the costs of the associated pastoral services in the long run, the Church would have to generate a profit of 15 percent on its investment, which is something that even professional investors cannot achieve, let alone the Church. Without contributions of the church goers the church is unlikely to be able to generate sufficient income to cover its duties resulting from providing spiritual care. Currently, an average Roman Catholic

[40] *Ibidem*.

[41] Donations have not been widely used by the Roman Catholic Church as part of the business model. For instance, the Prague Archibishopric has used donations to cover operative costs only, however, some parishes pertaining to the Prague Archbishopric have earmarked insignificant amount of donations (ranging between EUR 2000 and EUR 2500 per year) for their economic activities. For more details on earmarking donations see PRAGUE ARCHBISHOPRIC. 2019 Annual Report (in Czech) [online]. 2020. [viewed 24 October 2022]. Available from: https://apha.cz/wp-content/uploads/2020/11/ap-vz-2019-web.pdf and PRAGUE ARCHBI SHOPRIC. 2020 Annual Report (in Czech) [online]. 2021. [viewed 24 October 2022]. Available from: https://apha.cz/wp-content/uploads/2021/09/ap-vz-2020-web-celek.pdf.

Church goer donates one euro per month towards the running of the Roman Catholic Church. Economically, the Roman Catholic Church has ended up in a trap, as it now possesses a lot of real estate, which cannot generate sufficient profit to cover its operational costs.

The authors would advise the Roman Catholic Church to abandon the top-down approach in favour of the bottom-up approach to get closer to its followers and to support local communities by projects which may not necessarily generate immediate income but would stabilize or even increase the amount of frequent church goers who in turn will be able to make frequent and stable donations for receiving spiritual care provided by the Roman Catholic Church.

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Drag-along and tag-along clauses in shareholder agreements - Czech law perspective

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Abstract: *Drag-along and tag-long provisions are customary components of rights granted to investors within the terms of venture capital and private equity transactions. The drag-along right entitles a shareholder or a group of shareholders wishing to sell their shares in the company to, under certain conditions, compel all other shareholders to sell their shares under the same terms. Conversely, the tag-along right ensures that, again under certain conditions, shareholders wishing to sell their shares cannot do so unless they also arrange for sale of the other shareholders' shares. Both drag-along and tag-along clauses are adapted from common law jurisdictions wherein the clauses often form a part of constitutional documents of companies, i.e., usually articles of association or certificates of incorporation. When used in the Czech Republic and other civil law jurisdictions, drag- and tag-along clauses are primarily included in shareholders' agreement as agreements standing aside articles of association, i.e., outside of corporate constitutional documents. This paper assesses the functionality of the drag- and tag-along clauses in the context of Czech law and analyses the challenges imposed by the local law on the effectiveness and enforceability of such clauses.*

Keywords: *constitutional documents, drag-along right, investors' and shareholders' rights, private equity, shareholders' agreements, tag-along right, venture capital.*

INTRODUCTION

Shareholder agreements, as agreements among shareholders of companies but concluded beyond the statutory constitutional documents, may regulate a wide range of aspects related to the shareholdership. In general, these aspects are rather variable and may include provisions related to protection of minority rights, resolution of deadlock, veto rights, or even regulation of relationships which are unconnected to the general governance of the company.[1]

Within certain business areas, however, shareholder agreements form a part of a whole transaction documentation set which serves in particular to protect the interests of one side of the transaction. Such is the case of venture capital and

[1] DUFFY, Michael J. Shareholders Agreements and Shareholders' Remedies Contract Versus Statute? Bond Law Review [online]. 2008 [viewed 30 September 2022]. ISSN 2202-4824. Available from: doi:10.53300/001c.5517 (p. 4).

private equity transactions which have become increasingly common in the Czech Republic in recent years.[2] Investors within venture capital and private equity deals seek to have their interest and especially the value of their investment secured by means of certain mechanisms incorporated usually both in the company's constitutional documents and in shareholder agreements[3]. These protective mechanisms and covenants typically take form of specific investor-related rights some of which may also be incorporated in the investor (preferred) shares[4].

Covenants related to the final stage of the investment "lifecycle", i.e. sale of shares (a so called "exit") represent a type of such rights designed to secure the value of the investment[5]. The covenants will usually, beyond familiar instruments such as right of first refusal, include rules aiming at coordinated sale of shares in the company – drag-along rights and tag-along rights.

In common law jurisdictions venture capital and private equity transaction documentation has become standardised over the course of time[6]. Given that there is a market standard in the venture capital and private equity documentation, the concepts from foreign model documentations understandably influence the draftspersons of local shareholder agreements. Resulting that, we may now encounter drag- and tag-along clauses adopted from foreign jurisdictions in shareholder agreements governed by Czech law. Such adaptation then implies the question of effectivity and enforceability of the "imported" clauses.

This paper analyses drag-along and tag-along rights. First, based on international scholarly literature, it describes the general concepts of the rights. Second, drawing on the submitted description, the paper reviews the current regulation of such rights under Czech law. Third, it examines if any and what devices of the local law can be used when structuring the tag- and drag-along rights in a way which would ensure their proper functionality and enforceability in the context of Czech law.

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[2] See for example the CVCA Private Equity Report, Deal activity in 2021: 2021 Activity Report of the Czech Private Equity & Venture Capital Association, produced by Deloitte in association with the Czech Private Equity & Venture Capital Association [online]. June 2022. [viewed 30 October 2022]. Available from: https://cvca.cz/wp-content/uploads/2022/06/CVCA-Activity-Report-2021.pdf. The report notes, among others, that 2021 marked the record in venture capital transactions and identifies also significant growth in private equity deals.

[3] Even though shareholder agreements in the areas of venture capital and private equity have become a common feature of company law in the Czech Republic, they have attracted rather little attention in the Czech scholarly literature so far.

[4] LEISEN, Dietmar P. J. Staged venture capital contracting with ratchets and liquidation rights. Review of Financial Economics [online]. 2012, 21(1), 21–30 [viewed 29 September 2022]. ISSN 1058-3300. Available from: doi:10.1016/j.rfe.2011.12.003 (p. 22).

[5] BIENZ, Carsten, and Uwe WALZ. Venture Capital Exit Rights. Journal of Economics & Management Strategy [online]. 2010, 19(4), 1071–1116 [viewed 29 September 2022]. ISSN 1058-6407. Available from: doi:10.1111/j.1530-9134.2010.00278.x (p. 1072).

[6] See for example the model documentation of British Venture Capital Association available at: https://www.bvca.co.uk/Policy/Industry-Guidance-Standardised-Documents/Model-documents-for-early-stage-investments.

1. DRAG-ALONG AND TAG-ALONG RIGHTS IN GENERAL

Save for certain marginal exceptions[7], drag-along and tag-along rights are contractual devices lacking statutory substantiation. To establish their general concepts, one must thus refer to international legal scholarship.

1.1. Drag-along right

Drag-along right provides the majority shareholders[8] with the right to force the remaining shareholders to participate in a sale of the company (i.e. their shares).[9] The attractivity of drag-along right lies in the fact the majority shareholder wishing to sell their shares can effectively enforce sale of more shares than they own and through that maximise the sale price. It is because for a prospective buyer it is more attractive to buy the entire or a significant portion of a company rather than smaller portion which would imply that the buyer would, after the transition closing, deal with minority shareholders (i.e. the drag-along shall lead to execution of an "efficient or productive sale")[10]. Furthermore, by way of drag-along right, the majority shareholders ensure that they will be able to accomplish sale of shares at the time, terms and conditions that they will prefer.[11]

The drag-along right is commonly threshold-limited, the default percent-

[7] Cf. Section 202(c)(4) of the Delaware General Corporation Law: "a restriction on the transfer or registration of transfer of securities of a corporation or on the amount of such securities that may be owned by any person or group of persons is permitted by this section if it: Obligates the holder of the restricted securities to sell or transfer an amount of restricted securities to the corporation or to any other holders of securities of the corporation or to any other person or to any combination of the foregoing, or causes or results in the automatic sale or transfer of an amount of restricted securities to the corporation or to any other holders of securities of the corporation or to any other person or to any combination of the foregoing. (Emphasis added.) In: IRION, Doug, and Lynn M. LOPUCKI. The Readable Delaware General Corporation Law 2022-2023. SSRN Electronic Journal [online]. 2022 [viewed 30 September 2022]. ISSN 1556-5068. Available from: doi:10.2139/ssrn.4198565. Note that Delaware General Corporation Law specifically qualifies the right as *share transfer restriction*.

[8] Be it an individual majority shareholder or a group of shareholders holding the majority "controlling" share. For the ease of drafting this paper uses the term "majority shareholders" or "majority" to cover both aforementioned variants. Same applies to terms "minority shareholders" and "minority" used throughout this paper.

[9] LITTLE Robert B., and Joseph A. ORIEN. Issues and Best Practices in Drafting Drag-Along Provisions. The Harvard Law School Forum on Corporate Governance. [online]. 14 December 2016. [viewed 29 September 2022]. Available from: https://corpgov.law.harvard.edu/2016/12/14/issues-and-best-practices-in-drafting-drag-along-provisions/.

[10] LACAVE, Ma Isabel Sáez, and Nuria Bermejo GUTIERREZ. Specific Investments, Opportunism and Corporate Contracts: A Theory of Tag-along and Drag-along Clauses. European Business Organization Law Review [online]. 2010, 11(3), 423–458 [viewed 29 September 2022]. ISSN 1741-6205. Available from: doi:10.1017/s1566752910300061.

[11] LITTLE Robert B., and Joseph A. ORIEN, note 9.

age being 50% of the company (or shares carrying voting rights). Often, additional conditions strengthening or safeguarding the minority shareholders rights are stipulated for the majority shareholder to be able to invoke the drag-along right. Such conditions include for example a "black-out" period during which it is not at all possible to exercise the drag-along right, a minimum valuation of the company on which the sale price will be calculated or a minimum rate of return for the minority shareholders[12].

Corresponding to the right of the majority shareholders, the drag-along imposes obligations on the minority shareholders. The obvious obligation is to sell their shares within the transaction as desired by the majority.[13]

It is noteworthy that despite the fact that for example the Delaware General Corporation Law explicitly anticipates existence of drag-along rights[14], commentators mention that the case law related to drag-along is scarce and that the enforceability of the drag along provisions is uncertain.[15]

1.2. Tag-along right

Tag-along provisions customarily directly follow the drag-along provisions and very often use the same premises such as the triggering threshold (in terms of percentage and the scope of events). Whereas the drag-along right is designed to serve the majority shareholder, the tag-along right promotes the interests of minority shareholders as it obliges the majority shareholders who wish to sell their shares to facilitate an opportunity for the minority to sell their shares along with the majority. The tag-along right thus ensures that minority shareholders are not denied the opportunity to benefit from the premium of the majority stake sale, i.e. realisation of the value of their shares (this idea follows the concept of control premium assuming that the sale of a dominant stake in a corporation is able to procure a higher price, i.e. "control premium")[16].

The important part of the tag-along right is that the sale of the majority shareholders' stake and the minority shareholders' stake are executed on the same terms and conditions. The identity of terms, however, will primarily lie in terms of the purchase price (or price per share) as the minority shareholders may not

[12] FISCH, Jill E. A Lesson from Startups: Contracting out of Shareholder Appraisal. Iowa Law Review [online]. 2022, 107(3), 941–986 [viewed 29 September 2022]. Available from: https:// heinonline.org/HOL/P?h=hein.journals/ilr107&i=979 .

[13] LITTLE Robert B., and Joseph A. ORIEN, note 9.

[14] See note 7.

[15] The most common tool to ensure that the drag-along provisions are abided by is an irrevocable power of attorney being granted, within a shareholder agreement or aside, to the majority shareholders. Cf. The Enforceability and Effectiveness of Typical Shareholders Agreement Provisions. The Business Lawyer [online]. Chicago: Section of Business Law of the American Bar Association, 2010, 65(4), 1153-1203 [cit. 2022-09-30]. ISSN 0007-6899. Similarly, YATES, Geoff. A practical guide to private equity transactions. New York: Cambridge University Press, 2010. ISBN 9780521193115.

[16] YATES, Geoff, note 15 , and LITTLE Robert B., and Joseph A. ORIEN, note 9.

find for example non-compete undertakings customarily undertaken by the majority controlling shareholders acceptable.[17]

Unlike the drag-along, tag-along is not specifically mentioned in the General Corporation Law of the State of Delaware. However, there is no case law stating that such provisions would not be enforceable[18].

2. DRAG AND TAG ALONG RIGHTS IN CZECH LAW

As the aforementioned implies, drag-along and tag-along clauses constitute a type of share transfer restriction either on the minority, in case of the drag-along right, or on the majority in case of the tag-along right.

2.1. The regulation of drag- and tag-along rights in Czech law

In Czech law, general instruments restricting sale of shares are well known. Within the civil law, these instruments include right of first refusal (*předkupní právo*) under Section 2140 *et seq.* of Act No. 89/2012 Coll., the Civil Code, as amended (hereinafter the "Civil Code"),[19] as well as other reservations related to purchase agreements, e.g. buy-back reservation (*výhrada zpětné koupě*) under Section 2135 of the Civil Code, or the reservation of sell-back (*výhrada zpětného prodeje*) under Section 2139 of the Civil Code. As a rule, breach of these restrictions invokes only contractual liability, be it damages or contractual penalty, of the party in breach, but does not impair the validity of share transfer as such.

Czech corporate law anticipates restrictions by means of compulsory approvals of company bodies. Section 207 of Act No. 90/2012 Coll., on Business Companies and Cooperatives, as amended (hereinafter the "Business Corporations Act")[20] requires, within the context of the limited liability company (*společnost s ručením omezeným*) that the general meeting approves all share transfers to third parties (other than shareholders of the given company). Failure to obtain such approval renders the respective share transfer agreement ineffective (*neučinný*, i.e. valid, yet without any effects on the rights of the parties).

Similarly, with regard to the joint-stock companies (*akciové společnosti*), share transfers may be, under Section 270 (1) of the Business Corporations Act (subject to the articles of association so stipulating) restricted. Should a share transfer be conditional upon the consent of a company body (i.e. the board of

[17] The Enforceability and Effectiveness of Typical Shareholders Agreement Provisions, note 15.
[18] Ibid.
[19] Act No. 89/2012 Coll., the Civil Code, as amended [zákon č. 89/2012 Sb., občanský zákoník, v platném znění].
[20] Act No. 90/2012 Coll., on business companies and cooperatives (the business corporations act), as amended [zákon č. 90/2012 Sb., o obchodních společnostech a družstvech (zákon o obchodních korporacích), v platném znění].

directors or the administrative board, or alternatively the supervisory board), failure to obtain such consent, same as in the case of the limited liability company, results in ineffectiveness of the respective shares transfer agreement (Section 271 (1) of the Business Corporations Act). However, the Business Corporations Act further envisages that other restrictions may be imposed on share transfers and stipulates that if such other requirements are not met, the share transfer is invalid (*neplatný*, see Section 271 (3) of the Business Corporations Act).

Neither the Civil Code nor the Business Corporations Act, however, regulates situations where the transfer restrictions lie in co-sale obligations or rights, i.e. drag- or tag-along right, respectively. The stipulation of such rights, and correlating obligations are then typically found only in the shareholders agreement which renders their effect to be solely of obligational character (*obligační, závazková povaha*)[21], i.e. between the respective contractual parties. The agreement on drag- and tag-along will be considered as innominate contract within the meaning of Section 1746 (2) of the Civil Code. It is then in the sole discretion of the parties to the shareholders agreement, whether they will reflect or repeat the drag- and tag-along stipulations also in articles of association.[22]

2.2. Drag-along clause structuring

If, as mentioned above, the drag-along clause constitutes solely an innominate contract, the basic remedial measure for a breach of the minority obligation is for the majority shareholder to claim damages (*nárok na náhradu škody*) caused by the breach of contract (Section 2913 of the Civil Code). However, it would be rather difficult to assert the amount of damages caused by the non-performance of the drag-along obligation. Therefore, a contractual penalty within the meaning of Section 2048 of the Civil Code may serve better as a preventative measure of non-compliance. It must be noted, however, that such a contractual penalty shall be proportionate to the value of the obligation it secures (Section 2051 of the Civil Code).

Neither the compensation of damages nor the contractual penalty nonetheless has the capacity to force the obligated party to sell its shares alongside the majority shareholder. A question then arises, whether there are any legal devices already known by the local law which could be used to structure the clause, and which would serve the majority better than just an innominate contract. Based on the merits of the right described above, the potential scenarios are as follows:

- drag-along right being construed as the contract on future contract between the majority shareholders and the minority shareholders,

[21] ČERNÁ, Stanislava. Vedlejší dohody (sideletters) společníků kapitálových společností. Obchodněprávní revue. 2011(1), 1 – 10.

[22] Ibid. However, it must be noted that such a repetition will not per se change the obligational character of the provisions. In other words, the incorporation of such clauses in the articles of association will not render, in case of non-compliance, the share transfers void.

whereas in case of non-compliance by minority shareholders, the majority will be entitled to assign (*postoupit*)[23] the contract to the buyer of shares[24],

- drag-along right being construed as the contract on future contract between the majority shareholders and the minority shareholders – in favour of a third party, i.e. the future buyer of the shares[25],
- the drag-along right being construed as the option contract (i.e. an irrevocable offer to sell shares) in favour of the majority shareholders which will be, in case of the minority shareholders' non-compliance assigned to the buyer.

Construing the drag-along clauses in the way suggested provides an additional layer of protection for the majority compared to a simple innominate contract. In case of default on the part of the minority, there will be a judicial remedy available to the majority - the action for substitution of performance[26] (*žaloba na nahrazení projevu vůle*) under the Czech Code of Civil Procedure[27]. The necessity to construe the right based on either contract on future contract (*smlouva o smlouvě budoucí*) within the meaning of Section 1787 *et seq.* of the Civil Code or as an option contract (*opční smlouva*), ensues from the fact that such an action is admissible only if there is a statutory authorization (*zákonné zmocnění*) or if the court by its decisions solely declares or confirms the obligation which was not performed[28]. Should the drag-along clause be structured only as an innominate contract, it would be necessary for the court to create, i.e. constitute, the legal relationship between the minority shareholder in breach and the buyer of the shares – which the doctrine concludes is not permissible.[29] However, application of either the device of contract on future contract or option contract, the court would have a basis on which it would be able to determine the content of the

[23] Cf. ŠVESTKA, Jiří, Jan DVOŘÁK, Josef FIALA, Martin ŠEŠINA a Karel WAWERKA. Občanský zákoník: komentář. 2. vydání. Praha: Wolters Kluwer, 2019–2021, ISBN 978-80-7598-412-8.

[24] The contract on future contract is generally assignable, see Section 1895 of the Civil code. Cf. also e.g. LAVICKÝ, Petr, Jakub HANDRLICA, Jiří SPÁČIL, et al. *Občanský zákoník: komentář*. 2. vydání. Praha. C.H. Beck, 2020 - 2022, 4 svazky. ISBN 978-80-7400-852-8.

[25] The possibility to conclude the contract on future contract in favour of a third party was confirmed e.g. in the decision of the Supreme Court of the Czech Republic dated 30 November 2005, file no. 33 Odo 824/2005. Cf. also LAVICKÝ, Petr, Jakub HANDRLICA, Jiří SPÁČIL, et al. *Občanský zákoník: komentář*. 2. vydání. Praha C.H. Beck, 2020–2022, 4 svazky. ISBN 978-80-7400-852-8.

[26] The author's own translation. Cf. LAVICKÝ, Petr, Bohumil DVOŘÁK a Jiří HRÁDEK. Civilní proces. Řízení sporné: Občanský soudní řád (§ 1 až 250l). Praha: Wolters Kluwer, 2016, 1088. ISBN 978-80-7478-986-1.

[27] Act No. 99/1963 Coll., Code of the Civil Procedure, as amended [zákon č. 99/1963 Sb., občanský soudní řád, v platném znění].

[28] Cf. FLÍDR, Jan. Nahrazení projevu vůle společníka zavázaného z dohody o výkonu hlasovacích práv. In: EICHLEROVÁ, Kateřina. Rekodifikace obchodního práva - pět let poté. Praha: Wolters Kluwer, 2019, pp. 29 - 36. ISBN 978-80-7598-426-5.

[29] Cf. LAVICKÝ, Petr, Bohumil DVOŘÁK a Jiří HRÁDEK, note 26.

share transfer agreement between the minority shareholder and the buyer (as the third party).[30] Thus, the court could replace the transfer agreement between the minority shareholder and the buyer of the shares by its ruling.

2.3. Tag-along clause structuring

Conclusions made in paragraph 2.2. regarding the enforceability of drag-along rights are applicable to the tag-along right only to certain extent. The non-compliance of the majority shareholder with its obligation correlating to the tag-along right creates a potential claim for damages on the part of the "left out minority". Again, the majority's obligation can be secured by a contractual penalty.[31] It will not be feasible to construe the agreement as a contract on the future contract or option agreement because the performance required from the majority shareholders is limited to mere arranging for the buyer to buy the minority shareholders' shares.

With regard to tag-along right, however, it is possible to consider an enforcement mechanism from the corporate law realm - incorporation of the majority's tag-along obligation to arrange for the minority's co-sale as a share transfer condition in the articles of association (in line with Section 207 or Section 271 (3) of the Business Corporations Act, see paragraph 2.1. above). Should the majority then attempt to procure a share sale in non-compliance with the tag-along right, such transfer would be ineffective or invalid (depending on the type of business corporation concerned).[32] Thus, the majority shareholders' sale of shares will be impossible unless they comply with the minority shareholders' tag-along right.

2.4. Emplacement of the drag- and tag-along clauses

Paragraphs 2.2. and 2.3. anticipate that drag- and tag- stipulations will be drafted in a shareholder agreement and, if necessary, incorporated in articles of association. A question may then arise whether the discussed rights can be construed as special rights assigned to specific share classes.

The Business Corporations Act allows for creation specific share classes in Section 135 in the context of limited liability company and in Section 276 in

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[30] Ibid.

[31] As another sanction mechanism, a put option could be thought of in the context of a tag-long right breach. This would mean that in case of failure by the majority to tag the minority along, the minority shareholders would be entitled to sell all of their shares to the shareholder in breach. This way the minority would thwart the intention of the majority to exit the company. Put simply, the minority would say – if you leave without me, you will stay anyway. Cf. also LACAVE, Ma Isabel Sáez, and Nuria Bermejo GUTIERREZ, note 10.

[32] Cf. ŠPAČKOVÁ, Michala. Smluvní předkupní právo k akciím a právo odkupu. Obchodněprávní revue: odborný recenzovaný časopis pro obchodní právo a právo finančních trhů [online]. 2020 [viewed 29 September 2022]. ISSN 1803-6554.

the context of joint stock company. Legal scholarship confirms that especially the creation of special classes of shares in limited liability companies shall be rather flexible.[33] The same does not apply to joint stock companies, share classes of which may be created only by way of adding or removing *rights* (i.e. not obligations).[34]

In very specific cases within venture capital transactions, it would be conceivable to think of investor shares having the added drag-along and tag-along right towards the common shares. In turn, however, the common shares would bear additional obligations ensuing from the investor share rights. As noted, at least in the realm of joint stock companies this would not be feasible.

Furthermore, as explained in paragraphs 1.1. and 1.2. above the discussed rights relate principally to majority – minority relationships. Generally, therefore, unless there are significant differences in the value of specific shares, the majority – minority aspect shall be the decisive one with regard to qualification for the right (i.e. whether respective shareholders enjoy the rights or not).

It can be also noted that customarily rights and obligations vested in a share class represent rights and obligations *towards the company*. However, the drag- and tag-along rights apply *among shareholders*. This inference leads us back to the fact that drag- and tag-along rights primarily constitute share transfer restrictions and not rights and obligations assigned to shares. Lastly, given the proclaimed flexibility of share class creation in Czech limited liability companies, shares with drag- and tag- along classes can be theoretically created. Nonetheless, it can be concluded that incorporation of the discussed rights to shares would not enhance their enforceability. Resulting that one would still have to refer to the constructions outlined in paragraphs 2.2. and 2.3. above in order to foster enforceability of the discussed rights.

CONCLUSION

Drag- and tag-along rights are an inherent part of the set of rights negotiated by investors in venture capital and private equity transactions. In the Czech Republic, the provisions encompassing both these rights are often loaned from foreign standardized templates of shareholder agreements and constitutional documents. When used in contracts governed by Czech law, this may cause uncertainty as to the enforceability of such rights. This uncertainty is underlined by the lack of explicit regulation of both drag- and tag-along rights and shareholder agreements in general.

Nonetheless, this paper demonstrates that Czech civil and corporate law

[33] See ŠTENGLOVÁ, Ivana, Bohumil HAVEL, Filip CILEČEK, Petr KUHN a Petr ŠUK. Zákon o obchodních korporacích: komentář. 3. vydání. Praha: Beck, 2020, xvii, 1316: 347-350. ISBN 978-80-7400-799-6.

[34] Ibid.

are capable to accommodate the enforcement of shareholders' rights so that shareholders do not need to rely solely on *ex post* pecuniary remedies such as damages or contractual penalties in the event of non-compliance by the obliged shareholders. Shareholders may use devices of the contract on future contract or option contract (following which they shall be able to request that the court substitutes the performance of the shareholder-in-breach). As noted, the tag-along right can even be incorporated into the articles of association as a transfer restriction, thereby effectively limiting the transferability of shares if the agreed obligations of the majority shareholders are breached.

All of the aforementioned, however, implies that it is advisable for the drag- and tag-along clauses not to be simply copied from foreign model documents into local contracts. For the rights and corresponding obligations to be *per se* enforceable before courts, the clauses shall be modified or supplemented in order to fit the existing devices already forming a part of the local law.

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[20] CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code, as amended [zákon č. 89/2012 Sb., občanský zákoník, v účinném znění].
[21] CZECH REPUBLIC Act No. 90/2012 Coll., on business companies and cooperatives (the business corporations act) [zákon č. 90/2012 Sb., o obchodních společnostech a družstvech (zákon o obchodních korporacích)].
[22] CZECH REPUBLIC Act No. 99/1963 Coll., Code of the Civil Procedure, as amended [zákon č. 99/1963 Sb., občanský soudní řád, v účinném znění].
[23] STATE OF DELAWARE Delaware Code, Title 8: General Corporation Law.

Contractual approaches to environmental liability in asset deals

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Abstract: *The Czech legislation recognises certain types of "environmental liability", including the obligations from various fields of law – a special obligation to prevent and remedy environmental damage, and administrative, criminal, and civil law liabilities. Unlike in case of share deals, where the liability remains with the acquired company, in case of asset deals the transfer of environmental liability depends on more factors, such as the type of liability and specific circumstances under which the liability originated. Both the seller and the purchaser may aim to minimize the impacts of threatening environmental liability by various contractual instruments. The paper deals with the contractual risk allocation for both parties of an asset deal, including the analysis of the environmental liability under the Czech law, and specific legal instruments of risk allocation, such as indemnifications, representations and warranties, or deferred payment of purchase price.*

Keywords: *Asset Deal, Deferred payment, Environmental damage, Environmental liability, Indemnities, Representations and Warranties.*

INTRODUCTION

With the increasing pressure on legal requirements arising from the environmental law, there is a growing interest among investors in issues relating to mitigation of potential risks arising from the environmental law related matters. When negotiating a position in a deal, it is advisable to reflect these aspects in contractual documentation to minimise the impact of the environmental related risks.

Usually, the environmental risks tend to be neglected in favour of the economic benefits of a transaction. However, potential liability for environmental related risks may have a significant negative impacts, whether the deal concerns

an acquisition of a share in a company, business enterprise (or its part), or just individually specified assets (in particular real properties).[1] Nevertheless, it seems that the environmental law issues are becoming more important in the mergers and acquisitions (M&A) process.[2] The parties should therefore address the environmental liability aspects in detail in the transaction documentation and agree on specific contractual instruments relating to the risk transfer.

The importance of environmental liability becomes particularly relevant in case of longer operating facilities where the environmental impact of their operation is not fully documented and recorded. Even proper environmental due diligence does not necessarily eliminate all risks to the parties and some hidden aspects related to environmental burdens persist. Due to the difficulty of detection and the latent nature of the risks, these aspects are mainly related to soil and groundwater pollution.[3]

Also, starting positions and interests of parties to a transaction are different. The seller wishes to transfer the asset 'as it is' and not to bear any negative costs caused by hidden environmental burdens (which they may or may not be aware of). The purchaser, on the other hand, seeks to acquire the asset free of defects and risks that could in any way jeopardise economic benefits associated with the acquisition.

Below, we will therefore attempt to analyse the different types of environmental liability and the contractual regime applicable to them, with an analysis of the benefits for the purchaser and the seller. In particular, such risks are addressed by the contractual instruments of risks allocation – a transfer of risks which is only effective between the parties *(inter partes)*.[4] Such instruments include a wide range of contractual clauses, including indemnities, representations and warranties, contractual penalties or deferred payments.[5]

The aim of this paper is 1) to identify and analyse potential environmental related risks arising from the environmental, criminal, administrative and / or

[1] This may be demonstrated by the importance which the contemporary M&A literature connects to the environmental related risks. Usually, the authors do not expressly include the environmental due diligence as a separate part of the due diligence process (basically only the general legal issues falling under the compliance and regulatory matters are covered). E.g. PONIACHEK, H. A. *Mergers and Acquisitions. A Practitioner's Guide to Successful Deals*. New Jersey: World Scientific Publishing Co. Pte. Ltd., 2019, p. 592, pp. 50-56. and DEPAMPHILIS, D. *Mergers and acquisitions basics. negotiation and deal structuring*. Oxford: Elsevier, 2010, p. 240. pp. 26.

[2] WILDE, M. Page 5 In: WILCE, M. Civil Liability for Environmental Damage: Comparative Analysis of Law and Policy in Europe and the US. *Wolters Kluwer Law International*, 2013.

[3] LOOSER, M.O.; PARRIAUX, A.; BENSIMON, M. Landfill underground pollution detection and characterization using inorganic traces. *Water Research*, PERGAMON-ELSEVIER SCIENCE LTD, 1999, Vol. 33, Issue 17, Page 3609-3616.

[4] BEJČEK, J., ŠILHÁN, J., et al. *Obchodní smlouvy. Závazky v podnikání*. Prague: C. H. Beck. 2015, p. 539. pp. 132 – 134.

[5] P. DEPAMPHILIS, D. *Mergers and acquisitions basics, negotiation and deal structuring*. Oxford: Elsevier, 2010, p. 240. pp 93 – 95.

civil law,[6] and 2) to specify the contractual instruments by which the parties may address such risks and allocate them to the other party. While specifying the respective contractual instruments in accordance with the above goal, both positions for the purchaser and the seller shall be taken into consideration.

Although the risks are usually borne by the party who has a chance to control the situation giving rise to a risk,[7] a negotiating strength of one party may very well result in a different risk allocation. Therefore, it needs to be pointed out that this paper intends only to outline possible variants of legal risk transfers and does not aim to provide a complex way of contract negotiation.

For the identification of the rights and obligations under the existing legislation, logical methods of analysis and synthesis will be used.[8] The results obtained under the analysis-synthesis method will be further abstracted to obtain specific approaches to risk allocation.[9]

1. OBLIGATION TO REMEDY ENVIRONMENTAL DAMAGE

Obligations to prevent and remedy environmental damage are special institutes introduced by Czech Act No. 167/2008 Coll., on the Prevention and Remedying of Environmental Damage and on Amendments to Certain Acts, as amended (the **"Environmental Damage Act"**). The Environmental Damage Act is a reflection of the obligation of the Czech Republic to transpose the European Union Directive 2004/35/EC, on environmental liability with regard to the prevention and remedying of environmental damage, therefore this matter is harmonised in all European Union Member States.

The obligation to take remedial measures does not fall within the regular liability for administrative delicts, but is characterised by an objective restitution obligation, which does not benefit an individual person, but rather the 'environment' itself. The moment when the obligation to take remedial action arises is the occurrence or discovery of environmental damage by the facility operator. The environmental damage can be therefore regarded as an unlawful situation which the facility operator is obliged to prevent under the Environmental Damage Act. In this context, the obligation to take remedial measures can be regarded mainly as a liability obligation, since in a particular case it is usually aimed at remedying

[6] KRSTINIC, D., BINGULAC, N., DRAGOJLOVIC, J. Criminal and civil liability for environmental damage. *Ekonomika poljoprivreda-economics of agriculture,* 2018. ISSN 0352-3462. Web of Science [viewed 2022-09-18].
[7] BEJČEK, J., ŠILHÁN, J., et al. *Obchodní smlouvy. Závazky v podnikání.* Prague: C. H. Beck. 2015, p. 539. pp. 131.
[8] KNAPP, V. *Vědecká propedeutika pro právníky.* PRAGUE: EURLEX BOHEMIA, 2003. p. 233. ISBN 80-86432-54-8. pp. 75 and 76.
[9] Ibidem, p. 67.

the unlawful situation which has arisen from the breach of the obligation to prevent the environmental damage.[10]

According to Section 3(3) of the Environmental Damage Act, the obligations are transferred to the legal successor of the facility operator.[11] Therefore, the liability is strict and does not require a fault of the facility operator, nor their predecessors. This principle of strict liability is broken in the case of environmental damage caused to protected species of wildlife or wild plants or natural habitats, where the perpetrator is jointly liable with the new facility operator. Although the perpetrator can usually be held liable under Section 12 of the Environmental Damage Act for the recourse claim, the restitution obligation (or the obligation to "remedy" the environmental damage) still primarily corresponds to the current facility operator.[12] From the point of view of an asset deal, it is therefore essential that the restitution obligation to remedy the environmental damage generally passes to the new operator of the facility the operation of which caused the environmental damage. An exception from this rule is the situation when the environmental authority carries out the remedial measures itself – the costs for remedial measures may be claimed directly against the perpetrator.

Therefore, the purchaser may be motivated to expressly include in the transfer agreement an obligation of the seller to indemnify them for any costs, expenses or damages incurred by the purchaser in connection with any potential remedial measures caused by the previous faulty unlawful state of the transferred facility. In this context, the purchaser may also consider including a contractual penalty in form of a lump-sum for any costs incurred while taking these remedial measures, and at the same time to reinforce the seller's declaration of the faultless state of the assets to be acquired. If the purchaser has strong doubts that any such environmental damage is likely to be remedied in a short time period, they may also agree to a deferred payment of the purchase price giving them the better position of not having to file their claim at court and enforce the claim in execution proceedings.

The seller, on the other hand, may be advised to include a contractual declaration by the purchaser that they are aware of the environmental condition

[10] The question of whether the nature of the obligation is a liability for breach of a primary obligation or a primary obligation itself is rather theoretical. It is irrelevant to the parties to the transaction and there are no further relevant consequences arising from the Environmental Damage Act for the parties.

[11] The transfer of the operation of the facility can therefore also be regarded as the very fact with which the transfer of the obligation is directly connected. While inspecting the legal regime of the ecological liability transfer in case of asset deals, it is important to asses whether any of the activities specified in the Environmental Damage Act is conducted also by the legal successor of the facility operator. Since the "facility operator" defined under Section 2 let. (i) of the Environmental Damage Act by the specified activity, only a transfer of such activities may trigger a change in the facility operator.

[12] Although the principle "Polluter pays" should apply here within the meaning of the Recitel (2) of the Directive 2004/35/EC, the Czech law allows to exclude such liability between the parties at least contractually.

of the assets or a land and a possible waiver of liability for the costs of remedying of any environmental damage under the Environmental Damage Act. Another contractual approach is also to limit the seller's obligation to indemnify the seller for costs incurred for remedying of any or specified environmental harm, either by setting a maximum amount of claims or by contractually adjusting the limitation period. It needs to be said that such allocation of risks is only effective between the parties, and the acceptability of such an approach highly depends on the business position in the deal.

Another aspect of liability for environmental damage is also the liability for public offences related to breaches of obligations imposed by the Environmental Damage Act. This in particular relates to the failure to take preventive or remedial measures, for which a fine of up to CZK 5 million (an equivalent of EUR 200 thousand) may be imposed. In the case of private entrepreneurs (whether legal entities or natural persons), it can be assumed that liability for this offence would be transferred to their legal successor together with the obligations to take remedial or preventive measures.[13] In the case of liability for an administrative offence, the parties may achieve a transfer of the negative economic consequences associated with the fines imposed, for example, by an obligation to compensate the other party for any fines imposed, damages or related costs incurred in connection with the administrative offence proceedings.

2. ADMINISTRATIVE AND CRIMINAL LIABILITY

Another aspect of environmental liability is public law liability for administrative offences and crimes. Public law liability for breaches of environmental laws is a complex system of legal norms helping to protect various areas of the environment, including air, water, landscape, soil, etc.[14] The ambition of this paper is certainly not to prepare a complete list of all administrative offences or crimes in the area of environmental law, but rather to define the basic approaches for the contractual allocation of public law environmental liability of asset deals.

In terms of the contractual treatment of risks allocation, two aspects of public law liability in particular must be taken into account. The first question is whether the respective breach concerns objective (strict) or subjective liability (for fault). The second important aspect (which is partially dependent on the previous question) is whether the transfer of the assets also results in the transfer of public law liability by virtue of succession.

[13] In this context, we cannot exclude the interpretation that the succession of liability for the public offense shall be independent of succession of liability for environmental damage withing the meaning of the Environmental Damage Act either. In such a case, liability for the public offence could only pass if the transfer represents a creditworthy part of the seller's business enterprise or assets (cf. the Judgement of the Czech Constitutional Court of 23 March 2016, File No. II. ÚS 840/14).

[14] E.g. Section 116 et seq. of Czech Act No. 254/2001 Coll., Water Act, as amended, and Section 20 et seq. of Czech Act No. 334/1992 Coll., Agricultural Land Protection Act, as amended.

The division of liability into subjective and objective liability is important in order to assess who will be liable for the fact giving rise to liability in the transaction. In case of subjective liability, the fault of the perpetrator (whether intentional or negligent) is required. If the breach was committed by the seller, the purchaser cannot be generally held liable for such a breach, except, of course, where there is a transfer of liability for an offence or crime resulting from legal succession (as described below). From the seller's perspective, it may be advisable to include an indemnity clause in an agreement holding them harmless from any costs or negative effects of penalties imposed for administrative offences or crimes arising from breaches of the environmental law which become apparent after closing an asset deal.

In the case of strict liability, fault and causation in relation to the consequence are not required, only the fulfilment of the objective elements of the facts is important. In view of the principle of *nulla poena sina culpa* applicable to criminal law, strict public law liability is only applicable in case of liability for an administrative offence.[15] Consequently, strict liability for environmental offences is generally imposed on the owners of problematic properties where an unlawful situation contrary to mandatory environmental standards is established (irrespective of whether the owner of such property caused such situation).[16] If the administrative proceedings are commenced after the transfer of the property, the purchaser is fully exposed to the consequences of strict liability for such an offence. Therefore, the purchaser may secure their position in the transfer documentation by negotiating an indemnification towards the seller holding the purchaser harmless for any costs suffered as a result of breach of environmental laws prior to the closing of the asset deal.

An exception to the foregoing legal regime is the transfer of criminal or administrative liability in case of legal succession, which applies unconditionally to legal entities and, in the field of administrative offences, also to natural persons engaged in business. The case-law of the Constitutional Court of the Czech Republic has concluded that also asset deals representing a transfer of a creditworthy part of a business may be considered as a legal succession for purposes of transfer of criminal liability.[17]

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[15] *A contrario* Section 13 (2) of the Czech Act No. 40/2009 Coll., Criminal Code, as amended.

[16] E.g. breaching an obligation to keep the property in a clean and orderly state under Section 66d (2) (b) of the Czech Act No. 128/2000 Coll., Municipalities Act, as amended.

[17] As ruled in the Judgement of the Czech Constitutional of the Czech Republic of 23 March 2016, File No. II. ÚS 840/14. This judgement is fully applicable also to the transfer of the liability for administrative delicts, since the legislation of the liability according to the Czech Act No. 250/2016 Coll., on Liability for Administrative Offences and Related Proceedings, as amended, is based on the same principles as the Czech Act No. 418/2011 Coll., on the Criminal Liability of Legal Entities and Proceedings Against them, as amended. The results have been also widely accepted by the criminal law literature DĚDIČ, J. Section 10 [Trestní odpovědnost právního nástupce právnické osoby]. In: ŠÁMAL, P., DĚDIČ, J., GŘIVNA, T., PÚRY, F., ŘÍHA, J. *Trestní odpovědnost právnických osob*. 2nd edition. Prague: C. H. Beck, 2018, p. 273.

Therefore, whether the liability is strict or subjective, the purchaser is entitled to claim against the seller for any loss suffered as a result of the seller's wrongful act (and this should also be expressly agreed in the transfer documentation). If the purchaser has strong indication that there may be any such transfer of administrative or criminal liability, they may also be advised to agree to a deferred payment of the purchase price.

Conversely, from the seller's perspective, it is preferable to expressly exclude any recourse claims for damages/harms caused by the transfer of such liability. In view of the *a priori* unknown recourse claims of the purchaser against the seller, it is in the seller's interest to limit such claims, either by capping the amount of liability or by shortening the time limitation period. The starting point for determining the time limitation period is the length of the time limitation periods in the respective acts governing the administrative and criminal liability under the current legislation, with a maximum period of 3 years for administrative offences and 10 years for the most serious environmental crimes.[18] However, it is also necessary to take into account the fact that in the case of a continuing offence the time limitation period starts to run only when the unlawful situation ends, in the case of a recurring offence on the last day of the partial attack.[19]

3. CIVIL LIABILITY

In a broader sense, also the civil liability may be in certain environmental-related cases considered as the environmental liability. This includes, for example, compensation for damage caused by the degradation of neighbouring land or compensation for damage to health caused by environmental contamination. Liability to compensate for damage or non-pecuniary harm falls primarily on the person who caused the damage or who had control over the unlawful situation.[20] It is therefore in the seller's interest to pass on the economic consequences of any liability to the purchaser, in particular by negotiating an indemnity clause for any costs incurred for civil law breaches toward third parties.

However, in some asset deals it may be recommended also to review, whether the transfer of assets is not accompanied by a transfer (or assumption) of

[18] Section 30 of the Czech Act No. 250/2016 Coll., on Liability for Administrative Offences and Related Proceedings, as amended, and the Section 34 in connection with the crimes listed in the head VIII second part of the Czech Act No. 40/2009 Coll., Criminal Code, as amended.

[19] Section 31 (2) of the Czech Act No. 250/2016 Coll., on Liability for Administrative Offences and Related Proceedings, as amended and Section 34 (2) of the Czech Act No. 40/2009 Coll., Criminal Code, as amended.

[20] Section 2895 and 2901 of the Act No. 89/2012 Coll., Civil Code, as amended. The liability is therefore a combination of a subjective and objective liability, because it is not always the perpetrator, who may be held liable. The same principle may be found also in other jurisdictions – e.g. BUHRING, M.A. Environmental civil liability: repair of private environmental damage. *Revista direito ambiental e sociedade*, 2018, vol. 7, issue 3, p. 295-319. ISSN 2316-8218. Web of Science [viewed 2022-09-18].

debts or similar effects. In particular, this is the case of transfer of a business enterprise or a part thereof or the transfer of property.

In the case of a transfer of a business enterprise (or a part thereof), there is a statutory transfer of debts and, without the creditor's (or victim's) consent, the seller remains the guarantor of those debts.[21]

A similar situation applies in the case of a so-called "transfer of property", which consists in the disposal of all or a proportionately determined part of the seller's property (it is worth mentioning here that even a single item representing the majority of the property transferred may constitute such a "proportionately determined part of property"). In this case the purchaser becomes jointly and severally liable for the debts together with the seller towards third parties for all debts relating to the transferred property. Therefore, it may be advisable to clearly define between the parties to the deal which debts will be discharged by which party against third parties (although such an agreement will be only effective *inter partes*).

CONCLUSION

Parties to asset deals should pay attention to the environmental liability aspects and reflect these aspects also in the specific provisions of the transfer documentation. In general terms, approaches to environmental liability can be summarised in the **Tab. 1**, showing both possible ways of negotiation for the seller and the purchaser.

However, the above principles cannot be applied to all types of transactions. In the case of share deals, the question of environmental liability depends purely on the setting of the economic parameters of the transaction. The responsible party remains the same and there is no transfer of any of the above types of liability. In particular, the purchaser can negotiate a right to a discount on the purchase price of the share or, if a problematic situation is suspected, a retention of the purchase price (deferred payment) can be recommended. The seller, on the other hand, can generally apply the approach of excluding or limiting the purchaser's claims.

[21] Section 2177 of the Act No. 89/2012 Coll., Civil Code, as amended.

Tab. 1 Contractual risk allocation in case of environmental liability

Purchasers' instruments	Type of Liability	Sellers' instruments
Seller's representations and warranties on the absence of any environmental damage Express indemnification claims for any environmental damages caused by the Seller Deferred payment of purchase price	**Environmental damage liability**	Purchaser's representation and warranties on awareness of the state of the property Limitation of the purchaser's claims
Indemnification for any impacts of objective administrative liability. Indemnification for any impacts of transfer of public law liability Deferred payment of purchase price	**Criminal and administrative liability**	Indemnification for any impacts of subjective public law liability Limitation of the purchaser's claims
Risk allocation in case of debt transfer	**Civil liability**	Indemnification for any costs incurred for civil liability

Source: the Authors

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[10] Judgement of the Constitutional Court of the Czech Republic of 23 March 2016. File No. II. ÚS 840/14. Available from: https://nalus.usoud.cz/Search/ ResultDetail.aspx?id=92025&pos=1&cnt=1&typ=result.

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[11] Directive 2004/35/EC of the European Parliament and of the Council of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage.

[12] CZECH REPUBLIC Act No. 334/1992 Coll., Agricultural Land Protection Act, as amended [zákon č. 334/1992 Sb., o ochraně zemědělského půdního fondu, ve znění pozdějších předpisů].

[13] CZECH REPUBLIC Act No. 128/2000 Coll., Municipalities Act, as amended [zákon č. 128/2000 Sb., o obcích (obecní zřízení), ve znění pozdějších předpisů].

[14] CZECH REPUBLIC Act No. 254/2001 Coll., Water Act, as amended [zákon č. 250/2016 Sb., o vodách a změně některých zákonů (vodní zákon)].

[15] CZECH REPUBLIC Act No. 40/2009 Coll., Criminal code, as amended [zákon č. 40/2009 Sb., trestní zákoník, ve znění pozdějších předpisů].

[16] CZECH REPUBLIC Act No. 418/2011 Coll., on the Criminal Liability of Legal Entities and Proceedings Against Them, as amended [zákon č. 418/2011 Sb., o trestní odpovědnosti právnických osob a řízení proti nim].

[17] CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code [zákon č. 89/2012 Sb., občanský zákoník].

[18] CZECH REPUBLIC Act No. 167/2012 Coll., on Prevention and Remedying of Environmental Damage and Amendment of Certain Acts, as amended [zákon č. 167/2008 Sb., o předcházení ekologické újmě a o její nápravě a o změně některých zákonů, ve znění pozdějších předpisů].

[19] CZECH REPUBLIC Act No. 250/2016 Coll., on Liability for Administrative Offences and Related Proceedings, as amended [zákon č. 250/2016 Sb., o odpovědnosti za přestupky a řízení o nich, ve znění pozdějších předpisů].

SECTION II
INSOLVENCY LAW

The Center of Main Interest (COMI) in Recent Case-law

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Abstract: *The paper deals with defining the Center of Main Interest (COMI) in judicial decisions at the European and national levels. The article presumes that the definition of the COMI in EU Regulation on insolvency proceedings (EIR) recast is still insufficient and the judicial body should precise the definition of the COMI. Moreover, the article supposes that the definition of the COMI is not fit for the decentralized economy. Firstly, the paper describes the definition of the COMI in EIR recast. Secondly, the article focuses on the review of case law and the evolution of the concept of COMI in judicial decisions. Finally, the paper will analyse whether the concept of COMI is convenient in the current legal framework and decentralized economy models. At the end, it will be argued that COMI looks like an adequate and rational criterion for common cross-border insolvencies. Lastly, the article also proposes the definition of COMI in the event of a decentralized economy.*

Keywords: *Centre of Main Interest (COMI); Cross-border insolvency, EU Regulation on insolvency proceedings (EIR), Insolvency.*

INTRODUCTION

The COMI[1] is the main principle for determining the jurisdiction according to EIR recast[2] in cross-border insolvencies. The jurisdiction sets the insolvency rules for debtors and creditors. The concept of COMI was adopted in Council Regulation (EC) No. 1346/2000 of 29 May 2000 on insolvency proceedingsand was interpreted by the Court of Justice of the European Union. The concept of COMI was gently amended in EIR. In 2019, the directive on preventive restructuring[3] was adopted.

The article focuses on the definition of the COMI in judicial decisions at

[1] Centre of Main Interest.

[2] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast) (hereinafter as „EIR recast“). Regarding the international "coordinates" in the outlining of the insolvency regime given by "EIR recast" see DIDEA, Ionel, ILIE, Diana Maria, (R)evolution of the insolvency law in a globalized economy, *Juridical Tribune - Tribuna Juridica*, 2019, 9 (1), p. 98-103.

[3] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on the 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 (hereinafter as „PRD").

the European and national levels and whether the definition of the COMI is sufficient in current law and economic development.

It is presumed that the definition of the COMI in EIR recast is still insufficient and the judicial body should precise the definition of the COMI. Moreover, it is supposed that the definition of the COMI is not fit for the decentralized economy.

The relationship between the EIR and the EU Directive on Preventive Restructuring (PRD) and its impact on jurisdiction is not still solved in recent literature nor in the case-law. The Court of Justice of the European Union (CJEU) might interpret rules for jurisdiction in the case of the debtor under preventive restructuring and following insolvency, but from my point of view, the CJEU resigns on interpretation in the case Galapagos[4]. Partly, this pre-insolvency request and commencing of insolvency proceeding was decided in case Arca[5] in the Czech Republic. Also, the application of the concept of COMI in the decentralized economy is not explored.

The COMI is generally interpreted in Czech literature by Brodec[6] and Bělohlávek.[7] Moreover the COMI is investigated in commentary literature by Brinkman,[8] Bork and Zwieten.[9]

The application of the COMI in the case of the bankruptcy of the cryptomarket is examined by Kokorin.[10]

So firstly, the current definition of the COMI in EIR recast will be introduced and the evolution of the concept of COMI will be addressed. After that, the recent case law interpreting the concept of COMI will be examined. Finally, it will be analysed whether the concept of COMI is convenient in the current legal framework.

With respect to logical methods, the methods of deduction, induction,

[4] Judgment of the Court of Justice of the EU of 24 March 2022. Galapagos BidCo. S.a.r.l. v DE and Others. Case C-723/20 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.Europa.eu.

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[6] BRODEC Jan. *Insolvenční řízení v kontextu mezinárodního práva soukromého*. Praha: Wolters Kluwer, 2021, 248. ISBN: 978-80-7598-995-6.

[7] BĚLOHLÁVEK, J. Alexander. EU and International Insolvency Proceedings. Regulation (EU) 2015/848 on Insolvency Proceeding. Commentary. Vol. I. Hague: Lex Lata 2020, 850. ISBN: 978-90-829824-3-5.

[8] BRINKMANN, Moritz. *European Insolvency Regulation*. Munchen: C. H. Beck, 2019, 579. ISBN 978-3-406-69858-3.

[9] BORK, Reinhard, ZWIETEN, Kristin. *Commentary on The European Insolvency Regulation*, Oxford University Press 2016, 1032. ISBN: 9780198727286.

[10] KOKORIN, Ilya. Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices In: LAZIĆ, V. – STUIJ, S. *Recasting the Insolvency Regulation Improvements and Missed Opportunities*. Hague: T.M.C. Asser Press, 2020, pp. 35–26. ISBN: 978-94-6265-363-4.

analysis and synthesis will be used. Considering the clash of different legal systems, the method of comparison will also be used.

The synthesis will then summarize individual isolated conclusions and create general conclusions from them. The induction method will also be used for de lege ferenda proposals, now examining the issue from partial to general one. Also, structural analysis of case law is used.

1. DEFINITION OF COMI

The concept of COMI shall be defined in the autonomous sense of European Union law in order to ensure a uniform interpretation of this boundary determinant in the European Union Member States. The interpretation must be based on the objectives and system of the regulation on insolvency proceedings, as well as general legal principles, and therefore must be interpreted independently of the national regulation of the EU Member States.

The COMI is defined as the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties.[11] The ascertainability of COMI was interpreted by CJEU in the case Eurofood.[12] The EIR emphasizes the ascertainability of the COMI by debtor's creditors and this principle is also mentioned in Recital 26 of the EIR. Determining the COMI, specific attention should be paid to creditors and their opinion about where the debtor manages their interests. The information where the debtor administers their interest might be derived from postal address, country code of phone number, address to which financial statement refers, location of factories or warehouse, address of CEO etc.[13]

1.1. Definition of COMI in case of individuals not exercising professional activity

The COMI shall be presumed to be the place of the individual's habitual residence.[14] Furthermore, the habitual residence has not been moved to another EU Member State within six months prior to the request for commencing the insolvency proceeding.

When determining the COMI of an individual, it is also necessary to take into account all the activities of the person concerned. According to the CJEU, the habitual residence is determined by the person concerned having the intention

[11] Art. 3 EIR.
[12] Judgment of Court of Justice of the EU of 2 May 2006. *Eurofood IFCS Ltd.* Case C-341/04 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.
[13] BRINKMANN, Moritz. *European Insolvency Regulation*. Munchen: C. H. Beck, 2019, p. 51.
[14] Art. 3 EIR.

of permanent stay.[15] The COMI is not changed by a temporary stay in another State, e.g. temporary stay in prison.

Moreover, the habitual residence is not rebutted solely because the only immovable property of that person is located outside the Member State of their habitual residence.[16]

The specific situation might occur in case of debt discharge of spouse. It could be supposed that the COMI of each spouse will be determined separately.[17] This principle of separation of each debtor might be also derived from CJEU case Eurofood.[18]

1.2. Definition of COMI in case of an individual exercising an independent business or professional activity

The COMI shall be presumed to be that individual's principal place of business. Also, the condition for the restriction of moving the COMI before the commencement of insolvency proceeding is applied in the period prior to requesting the initiation of the insolvency proceeding.

The presumption of COMI is not rebutted by performing economic activities on behalf of a legal entity either. The interest of a legal entity is different from the interests of an individual doing business, even if this individual is also a statutory body and owner of a legal entity.[19]

1.3. Definition of COMI in case of legal entity

The COMI is presumed to be the place of registered office. That presumption shall only apply if the registered office has not been moved to another EU Member State within three month period prior to the request for commencing the insolvency proceedings.[20] The Czech court applied the head office function test for determining COMI.[21]

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[15] Judgement of Court of Justice of 17 February 1977. *Di Paolo v. Office national de l'emploi*. Case C-76/76 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.

[16] Judgment of the Court of Justice of EU of 16 July 2020. MH NI v. Novo Banco SA. Case C-253/19 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www. eur-lex.europa.eu.

[17] Compare BRODEC Jan. Insolvenční řízení v kontextu mezinárodního práva soukromého. Praha: Wolters Kluwer, 2021, p. 167.

[18] Judgment of the Court of Justice of the EU of 2 May 2006. Eurofood IFCS Ltd. Case C-341/04 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.

[19] Decision of the Court of Appeal - Chancery Division, United Kingdom 19 April 2007. No. [2006] EWHC 1186 (Ch). Official Receiver v. Stojevic & Anor. [accessed on 2022-09-20]. Available from: www.bailii.org.

[20] Art. 3 EIR.

[21] BRODEC, J. Applicable Law in International Insolvency Proceedings (Focused on the Relation of Articles 3 And 7 of the Insolvency Regulation. *Acta Universitatis Carolinae – Iuridica*. 2020, 4, p. 136.

The COMI cannot be rebutted through the financial contracts and exploitation of those assets in another Member State than the registered office.[22]

The CJEU interpreted COMI in the case Galapagos. The German court asked a preliminary question concerning the time for determining COMI; if it is applied at the time when the request to open insolvency proceedings is lodged or at the time of the decision about the request to open insolvency proceedings. This question is important due to the fact that the commencement of insolvency proceeding in several jurisdictions is not covered by the definition of insolvency proceeding by EIR. Similar problems might occur by interpretating the commencing of the preventive restructuring proceeding which is not covered by EIR and following insolvency proceedings. Unfortunately, the CJEU only found that the COMI was set by request to open insolvency proceeding and has not interpreted the connected question concerning the definition of commencing of each proceeding.[23] So the determination of connecting factor for jurisdiction in preventive restructuring is out of the scope of EIR in case that the proceeding is not listed in Annex A of EIR and subsequent insolvency proceeding could be unclear.[24] Suppose the COMI connecting factor should also be used for preventive restructuring and should be examined at the moment of commencing proceeding. It is not desirable to solve preventive restructuring in another jurisdiction than the insolvency proceeding. The CJEU brought forward the moment of examining the place of the debtor's main interests already in the Interedil case. This opinion can also be supported by the legitimate expectations of the participants.[25]

1.4. Definition of COMI in case of group of companies

The definition of COMI is based on CJEU decision Eurofood and separation of each company in group opposite to substantive consolidation that is possible in the United States.[26] EIR recast regulates coordination proceedings but on the other hand it does not involve any definition of presumption of COMI for a group of companies. The EIR defines parent undertaking and groups of companies[27] but daughter undertaking is not defined. The definition of groups cannot be

[22] Judgment of the Court of Justice of the EU of 20 October 2011. Interedil Srl, in liquidation v Fallimento Interedil Srl and Intesa Gestione Credit SpA. Case C-369/09 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.

[23] Judgment of the Court of Justice of the EU of 24 March 2022. Galapagos BidCo. S.a.r.l. v DE and Others. Case C-723/20 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.

[24] SCHMIDT, J. Preventive restructuring frameworks: Jurisdiction, recognition and applicable law. *International Insolvency Review.* 2022, 31, 81-100.

[25] Judgment of the Court of Justice of the EU of 4 September 2014. Burgo Group SpA v Illochroma SA, in liquidation. Case C-327/13 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.EU.

[26] KOKORIN, Ilya. The Rise of 'Group Solution' in Insolvency Law and Bank Resolution. *European Business Organization Law Review.* 2021, 22, p. 800.

[27] Art. 2 (13) EIR.

based on national rules for tax, commercial or accounting regulations, but the interpretation of the COMI in the case of company groups should be autonomous.[28]

The CJEU prefers the approach based on Interedil[29] decision on the possibility of rebutting the presumption of COMI. The presumption of COMI cannot be rebutted in case where management of the debtor or the place of carrying business are in the same place as the debtor´s registered office. This concept might not reflect the reality within the organizational structure of the group of companies due to the fact of internal connection and impossibility of separation of each unit of the group. The CJEU upheld that the extension of effects of insolvency proceedings opened in another EU Member State against another company established within the territory of that other EU Member State, the mere finding that the property of those companies has been intermixed is not sufficient to establish that the COMI of the company concerned by the action is also situated in that other EU Member State.[30]

1.5. Definition of COMI in case of the decentralized groups

The EIR recast has not solved the definition of COMI for decentralized groups. For the decentralized groups for current rules that are based on organized corporations and entities are not convenient. The main interpretation obstacle might be seen what is ascertainable for creditors in the decentralized entity. Kokorin mentioned that decentralized economy platforms might face problems with the ascertainability of COMI in the virtual world.[31] Participants on decentralized economy platform might operate in different states and so it might be impossible to set one place of COMI in such a platform.

The application of current case law of CJEU is not desirable and might interfere with the effectiveness of a decentralized economy model due to dividing the model into individual participants. If COMI is not ascertained, the solution

[28] PEPELS S. Defining groups of companies under the European Insolvency Regulation (recast): On the scope of EU group insolvency law. *International Insolvency Review*, [online] 2020. Available from: https://doi.org/10.1002/iir.1402 [cit. dne 29.09.2022].

[29] Judgment of the Court of Justice of the EU of 20 October 2011. Interedil Srl, in liquidation v Fallimento Interedil Srl and Intesa Gestione Credit SpA. Case C-369/09 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.

[30] Judgment of the Court of Justice of the EU of 15 December 2011. Rastelli Davide e C. Snc v Jean-Charles Hidoux. Case C-191/10 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.

[31] KOKORIN, I Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices In: LAZIĆ, V. – STUIJ, S. *Recasting the Insolvency Regulation Improvements and Missed Opportunities*. Hague: T.M.C. Asser Press, 2020, p. 38.

might be the application of the theory of contractualism which says that the participant should conclude an agreement about jurisdiction.[32] In case of preventing forum shopping, it might be the agreement of the majority or qualified majority of the current creditors prior to the commencement of insolvency proceeding. Also, the creditor harmed test could be a prevention tool before abusing forum shopping.[33]

2. COMI IN RECENT CASE LAW

The last decision of CJEU solved the problem of determination of COMI in the time of request of the open insolvency proceeding and the decision to commence insolvency proceeding. This decision could also be applicable to the relationship between commenced preventive restructuring proceedings and subsequent insolvency proceedings. It is important to mention that this relationship is not directly mentioned in the judgment.

In the case of Galapagos, the request for opening insolvency was filed on 22 August 2022 in the UK because of settlement between creditors and debtors and the insolvency petition was filed on 23 August 2022 in Germany. The registered office of Galapagos was in Luxembourg and the administration was transferred to the UK in June 2019. The creditors filed the insolvency petition in Germany and Galapagos appealed. The German High Court submitted a preliminary reference whether COMI is in Germany or in UK in the case that a UK court has not decided about insolvency and preventive restructuring. The CJEU ruled that the EU Member State with which a request to open the main insolvency proceedings has been lodged retains exclusive jurisdiction to open such proceedings where the COMI has moved to another EU Member State after that request has been lodged, but before that court has delivered a decision on it.[34] The UK court had jurisdiction because of it did not deny its jurisdiction in insolvency matters.

A similar problem might occur in preventive restructuring due to the fact that EU Member States might choose whether the preventive restructuring falls within the scope of EIR recast or not. So different criteria might interfere for determination of jurisdiction. Skauradszun prefers considering the insolvency in case of preventive restructuring as a commercial matter.[35] This commercial mat-

[32] RASMUSSEN, K.R. *A* New Approach to Transnational Insolvencies. *Michigan Journal of International Law* [online] 1997. Available from: https://repository.law.umich.edu/mjil/vol19/iss1/ [accessed on 2022-09-29].
[33] RINGE, W. G. Insolvency Forum Shopping, Revisited. *Hamburg Law Review* 2017, 3, p. 51.
[34] Judgment of the Court of Justice of the EU of 24 March 2022. Galapagos BidCo. S.a.r.l. v DE and Others. Case C-723/20 [online]. In EUR-Lex. [accessed on 2022-09-16]. Available from: www.eur-lex.europa.eu.
[35] SKAURADSZUN, D. NIJNENS, W., Brussels Ia or EIR Recast? The Allocation of Preventive Restructuring Frameworks. *International Corporate Rescue*. 2019, p. 200.

ter might be supported by the nature of the agreement about capitalization or merger.[36]

It might be seen how the national courts decide similar cases. The Czech court overcomes the interpretation of the COMI in the Arca[37] decision. The debtor asked for a moratorium before the Slovak court due to the COVID-19 pandemic. Subsequently, the debtor moved the COMI from the Slovak to the Czech Republic and requested opening the insolvency proceeding before a Czech court. The Czech municipal court in Prague deny the request, but the High Court in Prague reversed the decision and held that the COMI of the debtor Arca is in the Czech Republic. The main reason was that pre-insolvency moratorium due to COVID-19 is not under the scope of the EIR and the COMI is determined according to the head office function test in the Czech Republic.

So, it is apparent that determining the COMI is based on the interpretation of insolvency rules and pre-insolvency rules. Legal scholarship argues, that in pre-insolvency, the jurisdiction might be based on lex societatis or lex contractus.[38] The pre-insolvency rules out of the scope of the EIR recast might cause obstacles and positive or negative jurisdictional conflicts. Loop-holes between the EIR and other regulations should lead to the adoption of precised legal rules.[39]

CONCLUSION

To conclude a CJEU decision and a decision of the Czech High Court concerning COMI have been addressed. Also, the interpretation of the COMI in this paper was examined, especially with a focus on the moment of commencing preventive restructuring or insolvency proceeding. The decision of the CJEU and the Czech High Court might be seen contradictory due to the aspect of commencing preventive restructuring and subsequent moving of the COMI. The hypothesis of the paper has been confirmed: The EIR recast has not exactly solved the jurisdictional relationship between preventive restructuring and insolvency proceedings and it could lead to positive or negative conflicts of jurisdiction. Also, the EIR recast might be old-fashioned to the decentralized economy because the COMI might not be ascertainable.

Therefore, preventive restructuring should be regulated with the same

[36] SCHMIDT, J. Preventive restructuring frameworks: Jurisdiction, recognition and applicable law. *International Insolvency Review.* 2022, 31, p. 86.

[37] Judgement of the Vrchní soud v Praze, Czech Republic 13 October 2021. No. 4 VSPH 816/2021 [online]. In *Insolvenční rejstřík*. Ministerstvo spravedlnosti. [accessed on 2022-09-20]. Available from: www.justice.cz.

[38] SCHMIDT, J. Preventive restructuring frameworks: Jurisdiction, recognition and applicable law. *International Insolvency Review.* 2022, 31, 81-100 or CASASOLA, O., The transaction avoidance regime in the recast European insolvency regulation: Limits and prospects, *International Insolvency Review*, 2019, 28, pp. 7-9.

[39] MCCORMACK, G. Reconciling European Conflicts and Insolvency Law, *European Business Organization Law Review*, 2014, 15, p. 331.

principles applicable to COMI for insolvency proceeding. So, the validity agreement between the debtor and the creditor in preventive restructuring would be resolved. Furthermore, the transactions in preventive restructuring would be governed by the same law. This should help remove legal uncertainty.

In case of the decentralized economy the possibility to conclude the jurisdiction or announce the insolvency jurisdiction before entering into a contract in founding statute should be enacted. To prevent forum shopping the creditor harm test should apply.

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

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Preventive Restructuring: Business Viability in Impending Insolvency

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***Abstract**: The Directive (EU) 2019/1023 on restructuring and insolvency lays down rules on preventive restructuring frameworks available for debtors in financial difficulties when there is a likelihood of insolvency, with a view to preventing the insolvency and ensuring the viability of the debtor. The impending insolvency represents a critical condition on the verge of total economic and business failure. Until now, the Czech legal system has only offered the tools of formal insolvency proceedings to resolve such difficulties (particularly the concept of formal reorganization). The article examines whether the impending insolvency can also be averted by using the new procedure of preventive restructuring and to what extent the maximum degree of economic distress of the debtor may be still accepted. For such purposes, the authors assess a concept of a viability test.*

***Keywords**: impending insolvency, insolvency proceedings, preventive restructuring, resolution.*

INTRODUCTION[1]

The concept of preventive restructuring introduced into national legal systems of EU Member States by transposing the Directive (EU) 2019/1023 of the European Parliament and of the Council on restructuring and insolvency[2] has swiftly become the main topic of current discussions taking place among both

[1] 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 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 (Directive on restructuring and insolvency).

legal and economic professionals, and a long-awaited resolution alternative to traditional formal insolvency proceedings by corporate debtors.

Speaking of existing insolvency proceedings, the main source of Czech insolvency law is the Insolvency Act[3] (hereinafter also "InsA") effective since 2008. In contrast, the concept of preventive restructuring still has not been introduced to the Czech legal order despite the expiration of an extended deadline for transposition of the above-mentioned directive. During the fourth quarter of 2022, the draft Act on Preventive Restructuring (hereinafter also "DAPR") is still undergoing final revision after many comments and suggestions have been raised by the Government Legislative Council. After their incorporation the draft Act will be hopefully approved by the government and submitted to the Parliament of the Czech Republic.

Understandably, the relationship between insolvency proceedings and preventive restructuring has not yet been described by jurisprudence nor resolved by case-law at all. As DAPR is still under legislative scrutiny, only a few authors dedicated their efforts to compare ideological starting points (Vítková, Zezulka)[4], procedural scheme of both procedures (Pondikasová, Zemandlová)[5] or selected legal problems (Havel[6], Schönfeld[7]).

The concepts of preventive restructuring and insolvency proceedings have a number of common elements. In general, both of them can be defined as collective instruments, the purpose of which is to solve the unfavourable economic situation of debtors. In addition to others, however, they also differ in one key attribute, which can be defined as the "minimum and maximum degree of economic distress" to qualify within the very limits of the substantive scope of both institutes.[8]

The main aim of the article is to examine whether the impending insolvency can be also averted by using preventive restructuring framework and to

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

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[7] SCHÖNFELD, Jaroslav. Používání pojmů "finanční obtíže" a "hrozící úpadek" v evropské směrnici o restrukturalizaci a insolvenci. In: SCHÖNFELD, Jaroslav, et al. *Insolvenční praxe (Problémy a výzvy pro léta dvacátá)*, Prague: C.H. Beck, 2020, pp. 31-39.

[8] 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, Klára, ZEZULKA, Ondřej. Nový institut preventivní restrukturalizace a inspirace zahraničními úpravami. 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.

what extent the maximum degree of economic distress may still be accepted. The main hypothesis is that, under specific circumstances, both concepts may be used to resolve financial difficulties of the debtor, specifically to avert the state of the so-called "impending insolvency".

As to the methods employed, the introductory chapters dealing with conceptual terms mostly use description and analysis. Their aim is to present the current state of jurisprudence and case law regarding the economic and legal perception of impending insolvency and qualification criteria of financial difficulties resolution via insolvency proceedings and preventive restructuring in Czech laws. Then, logical methods of deduction, induction, analysis and synthesis will be used to draw up a framework of common prerequisites of successful aversion of impending insolvency via preventive restructuring.

1. THE SUBSTANTIVE SCOPE OF APPLICATION OF INSOLVENCY AND RESTRUCTURING FRAMEWORKS

The Czech insolvency law primarily focuses (almost) exclusively on resolving bankruptcy situations that occur after the conditions of illiquidity[9] or over-indebtedness[10] have been met. The authors do not overlook that the legal regulation allows the debtor to initiate the insolvency proceedings even in cases of the so-called impending insolvency[11] (an elaborated interpretation of this concept will be presented in the next section), or while averting the impending insolvency by using a time-limited protection provided by a moratorium[12]. However, these procedural strategies are not further elaborated in the normative text and the legislator did not closely bind them to remedial methods of resolving corporate crises. In its consequence, these institutes are rather used in practice as a defensive or delaying procedural strategy of debtors in order to maximally extend the control of their assets and the day-to-day operation of their business.[13]

In contrast, DAPR stipulates that the approval of the restructuring plan can only be achieved for a debtor who is not bankrupt in the form of illiquidity, but taking into account all the circumstances, it could reasonably be assumed that

[9] Illiquidity is defined as a situation when a debtor has multiple creditors, mature financial liabilities for more than 30 days overdue and is not able to fulfil such liabilities (e.g. debtor stopped the payments for the substantial part of their financial liabilities or their liabilities defaulted for more than 3 months overdue). See Section 3 (1) and (2) InsA.

[10] Over-indebtedness is defined as a situation when a debtor has multiple creditors and their liabilities exceed the value of their property (but taking into account the going-concern added value). See Section 3 (4) InsA.

[11] See Section 3 (5) InsA.

[12] For the duration of the moratorium, the decision on the insolvency may not be issued. Yet, the insolvency proceedings against the debtor may be commenced and the effects associated with its commencement remain in force. See Section 115 et seq. InsA.

[13] The results of quantitative research showed that 94% of debtors who took advantage of the protective moratorium eventually ended up in bankruptcy. See SCHÖNFELD, Jaroslav et al. Insolvenční praxe: problémy a výzvy pro léta dvacátá, pp. 52-53.

their financial difficulties are so serious that, in the event of not accepting the proposed restructuring measures, their bankruptcy occurred by mere passage of time.[14] At first glance, it may seem that DAPR does not hypothetically prohibit a debtor from undertaking preventive restructuring even when formally over-indebted (i.e. net worth of debtor´s assets is negative). The authors cannot accept such conclusion as a genuine difference unfolds in terms of viability test results.[15] It is worth mentioning that neither the InsA nor the DAPR introduce formal viability tests. Both regulations implicitly assume that such prerequisite is met when a minimum required majority of creditors supports a non-liquidation course of action (i.e. going-concern scenario).

The viability test verification may result in two possible outcomes. While the definition of bankruptcy assumes a negative result of the viability test (i.e. the net value of the business under debtor's administration does not reach positive numbers in foreseeable future)[16], an availability of preventive restructuring framework requires a positive result (i.e. the debtor is able to preserve or restore their own business through application of effective restructuring measures)[17]. After all, this is also confirmed by the explanatory report to the DAPR, which states that "*a formal accounting state of bankruptcy (i.e. a currently negative value of assets) does not yet automatically mean over-indebtedness, if there is an assumption that the business will generate sufficient added value*".[18]

This perception results from the interpretation of very definition of over-indebtedness provided by the Czech Insolvency Act[19]. This corresponding provision states that debtor is considered bankrupt in form of over-indebtedness while having multiple creditors and their liabilities exceeding the value of their property. Yet, when estimating the value of debtor´s property, the further management of the property or the further operation of the business should be taken into account, provided that it may be reasonably assumed that the debtor will be able to continue managing their property or operating their business. Coherently to the abovementioned, the authors incline to the presume that a temporary negative net worth of the debtor´s assets may not be solely decisive in the medium to long term outlook if there is a decent chance of restoring the value of assets and simultaneously the debtor does not counter illiquidity.

As a result, the overlap between the minimum and maximum levels of economic distress in both concepts occurs only in the state of impending insolvency. From the point of view of insolvency proceedings, it represents the mildest

[14] See Section 4 (2) DAPR.
[15] Accordingly, to Article 4(3) of the Directive (EU) 2019/1023, the purpose of the viability test is to exclude debtors from restructuring procedures who do not have a prospect of viability.
[16] See Section 3 (5) InsA.
[17] See Section 4 (1) DAPR.
[18] *Draft Act on Preventive Restructuring:* Explanatory report [Section 4]. Portal apps.odok.cz, p. 28.
[19] See Section 3 (4) InsA.

accepted grade of economic failure of the debtor, while for preventive restructuring the impending insolvency serves as the maximum still tolerated degree of seriousness of the entrepreneur's financial problems, which is still worth the effort to avert. For comparison, the German approach on access to stabilisation and restructuring framework (StaRUG) is limited to cases of imminent illiquidity only where debtors are not yet obliged to file the insolvency petition.[20]

2. THE CONDITION OF IMPENDING INSOLVENCY

For the purposes of the following interpretation, the authors deem it necessary to examine the very definition of impending insolvency in more detail first. Impending insolvency is defined in InsA as a situation when "*given all the circumstances, it may be reasonably assumed that the debtor will not be able to duly and timely fulfil the substantial part of their financial liabilities*".

The definitional indeterminacy of this provision is the subject of persistent criticism from the expert public in legal theory. At first, by its very nature, it reflects only one of the rebuttable presumptions of bankruptcy in the form of illiquidity, in which the debtor has stopped paying a substantial part of their monetary obligations.[21] Moravec criticizes this concept that the legislator has insufficiently explained why the definition of impending insolvency is linked only to the assumption of illiquidity and not to the reasonably expectable over-indebtedness as well.[22] At the same time, Moravec raises a fair question what is meant by a reference to a substantial part of monetary obligations - whether this substantiality shall be expressed as a qualified percentage of debts or whether it is related to the relative importance or exposure of individual creditors. Sprinz, on the other hand, points to the fact that evaluating the fulfilment of such a vaguely formulated condition opens up an excessively wide margin of discretion for insolvency courts.[23]

As it may seem a secondary issue from the perspective of insolvency courts which are given wide discretion enabling broad assessment of all relevant aspects of the respective case, such mechanics contribute to a high degree of legal certainty of both debtors and creditors. In particular, statutory body members of business corporations may be negatively affected by such indeterminacy as reaching the impending insolvency situation triggers reactive measures regulated by Czech Business Corporations Act (hereinafter also "BCA")[24]. Omitting the responsibilities of members of statutory body (esp. convening the general meeting

[20] SCHULTZE & BRAUN: Insolvency and Restructuring in Germany. Yearbook 2021, Achern, 2020, p. 43.
[21] See Section 3 (2) (a) InsA.
[22] MORAVEC, Tomáš. § 3 [Úpadek]. In: MORAVEC, Tomáš, KOTOUČOVÁ, Jiřina et al. *Insolvenční zákon*. 4th edition. Praha: C. H. Beck, 2021, pp. 25–26.
[23] SPRINZ, Petr. Platební neschopnost a předlužení v řeči práva a ekonomie. *Obchodněprávní revue*, 9/2019, p. 225.
[24] Act No. 90/2012 Coll., on Business Companies and Cooperatives (Business Corporations Act).

of shareholders and taking appropriate action)[25], the members expose themselves to risk of liability for breach of duty or to even hand over the benefit obtained from the contract for the performance[26].

The authors agree with the reservations of experts and do not consider the legal definition to be precise enough either. It contrasts to the definition of bankruptcy, which can be more or less precisely identified through the analysis of the debtor's financial indicators. Yet, a fundamental difference while verifying impending insolvency should be pointed out. In InsA, this status is not based on rigorous analysis of the current financial status (i.e. an actual ability to meet mature financial obligations or net worth of assets), but rather on a more or less qualified prediction of future economic performance and estimated future cash-flow. As to the rather rare Czech case law, the Supreme Court stipulated that "*decisive facts that certify the impending insolvency of the debtor mean the description of specific circumstances from which the insolvency court (if found to be true) will be able to conclude (taking into account all the circumstances of the case) that it can be reasonably assumed that the debtor will not be able to properly and timely fulfil a substantial part of their cash obligations in the future*".[27] It follows that the multiplicity of creditors who possess mature claims is not strictly required in order to decide upon impending insolvency (multiplicity of creditors as such remains the core condition for decision upon bankruptcy under Czech law).

Tollenaar aptly addressed this issue by differentiating the earlier concepts of "likelihood of insolvency" from "imminent insolvency".[28] Tollenaar admits that the likelihood of insolvency by the nature of the matter always exists (as common entrepreneurial risk) and cannot therefore justify the initiation of formal proceedings itself.[29]

If we accept the thesis that the existence of impending insolvency cannot be precisely confirmed or denied on the basis of quantifiable economic criteria, from the perspective of the authors a test based on balance of probability should be applied. If the situation of the debtor is countered by an inevitably negative trend anticipated from a sufficiently justified and plausible business scenario developed for a foreseeable time outlook, the balance of probability shall entitle the debtor to initiate emergency actions including the commencement of an insolvency proceedings. If, on the other hand, the balance of probability speaks in favour of maintaining normal going-concern functioning, no intervention of public authorities in the course of averting a possible danger is either desirable or

[25] See Section 182 BCA.
[26] See Section 53 (1) BCA.
[27] Decision of the Supreme Court, case KSBR 37 INS 294/2008 29 NSCR 1/2008.
[28] TOLLENAAR, Nicolaes. The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings (June 1, 2017). *Insolvency Intelligence*, Vol. 30(5), 2017, p. 67.
[29] Decision of the High Court in Olomouc, case KSOL 41 INS 12808/2021 1 VSOL 482/2021-A-14.

permissible.

3. THE PREREQUISITES OF AVERSION OF IMPENDING INSOLVENCY BY PREVENTIVE RESTRUCTURING

Such course of consideration is fully consistent with the provisions of DAPR on material scope of application, especially on minimum required distress level. As once mentioned above, the core provision restricts the commencement or continuation in preventive restructuring only to debtors whose "*financial difficulties are so serious that if the proposed restructuring measures are not adopted, they would become bankrupt by the mere passage of time*".[30] So, the financially healthy debtor should not wilfully benefit from the suspensive or protective measures (e.g. stay on individual enforcement actions causing involuntary contracts lock-in)[31] to the detriment of creditors.

However, the authors intend to rather deal with the question under which conditions the currently being developed hybrid procedure of preventive restructuring can be effectively used to avert impending insolvency. The hybrid nature of preventive restructuring procedure is based on two phases – private negotiation and confirmation by judicial authority.

First of all, DAPR significantly limits the margin of courts´ discretion as it quite straightforwardly imposes rather objective tests that have to be evaluated before the restructuring plan is approved (foremost the best-interests-of-creditors test and the fairness test based on combined absolute-relative priority rule).[32]

The consequence is that the private negotiation phase resulting in restructuring plan composition serves as the real centre of gravity of private restructuring procedure. In this regard, the authors observe several core attributes which predetermine the success of averting the debtor´s financial problems in private negotiation phase of preventive restructuring – timely initiation, motivation and transparency (honesty) of the debtor, business viability and communication (negotiation skill).

Much has been written on timely initiation of recovery procedures. However, this attribute is closely linked to the motivation of the debtor and their management. Both positive and negative factors occur in practice. For example, in respect to the specifics of the Czech business environment formed primarily by owner managed small- and medium-sized companies, the psychology of owners plays a decisive role. Kuděj, Schönfeld and Smrčka consider the main problems "*the inability or unwillingness of managers - owners to critically assess the situation of their own company (which in many cases they spent years building)*".[33]

[30] See Section 4 (2) DAPR.
[31] See Article 7(4) Directive (EU) 2019/1023.
[32] See Section 117 (2) DAPR, or Section 28 DAPR.
[33] KUDĚJ, Michal, SCHÖNFELD, Jaroslav, SMRČKA, Luboš. Finanční charakteristiky podniků před vyhlášením moratoria. *Politická ekonomie*, Vol. 67 No. 5, p. 508.

Another obstacle can be seen in the fear from negative publicity (whilst insolvency proceedings runs in a full publicity mode, the negotiation phase of preventive restructuring does not necessarily need to be disclosed to the broad public).

High importance shall be attached to fluent communication between the debtor and the creditors. Unlike insolvency proceedings where an insolvency petition is sent solely to the court, the preventive restructuring is commenced by the debtor via sending out a call to start negotiations to all or some creditors. Maintaining fluent communication channels is crucial not only for drawing up a sound restructuring plan but also to ensure sufficient support for its approval by a qualified majority of creditors. Mitigating trust issues towards creditors is generally recommended for debtors. As Zhang reminded, in the vicinity of insolvency, creditors are pushed to take actions in order to not to be completely overlooked.[34] According to previous papers of the authors, there is an indirect proportion – the higher the degree of consensus across the restructuring forum, the lower the intensity of opposition of creditors which inevitably leads to an intervention of the court, application of suspensive legal measures by the debtor or even failure of the procedure.[35]

Transparency should be a mere side-effect of communication. If the debtor aspires to gain support from their creditors, they are expected to provide sufficient information about their situation. Documentation referred by DAPR as "remedial project" serves this very purpose as it shall reduce information deficiency of creditors by presenting them accurate and credible data on the debtor´s business. Even a draft proposal for restructuring measures, a draft financial and business plan and requested means of assistance from creditors and financial institutions shall be included.[36] The reason is that the legislator expected that only creditors supplemented by sufficient information will make informed decisions of approval (otherwise they would probably tend not to cooperate). This thesis can be supported by conclusions made by Sumandea-Simionescu who proved that even though information asymmetry may be applicable to a communication strategy in cases when a unanimous agreement of the creditors is not required, such an option is not the best and must be well thought out and considered *ex ante*.[37]

The last but extremely important criterion of the test is viability of the debtor´s business. The attribute of viability itself is a complex issue that works

[34] ZHANG, Daoning. Preventive Restructuring Frameworks: A Possible Solution for Financially Distressed Multinational Corporate Groups in the EU. *European Business Organization Law Review.* Vol. 20, issue 2, p. 20.

[35] VÍTKOVÁ, Klára, ZEZULKA, Ondřej. *O východiscích preventivní restrukturalizace a rozdílech oproti reorganizaci* in SCHÖNFELD, Jaroslav, et al. Preventivní restrukturalizace. Revoluce v. oblasti sanací podnikatelských subjektů. Prague: C. H. Beck, 2021, p. 66-67.

[36] See Sections 9 and 10 DAPR.

[37] SUMANDEA-SIMIONESCU, Ioan. On Efficiency, Bargaining Power and Information Asymmetry, a Legal and Economic Analysis of Alternative Legal Methods of Creditor Protection for *in bonis* Companies in Romania and England. *Journal of Public Administration, Finance and Law*. Issue 23, 2022, p. 306.

with the premise that maintaining the operation of the business brings more added value that its liquidation and dissolution. At a very bottom line of consideration, any party potentially affected by the restructuring plan shall evaluate whether they will be better-off of worse-off in case of adopting a restructuring plan. Such deliberation does not necessarily rest only in simple calculation of effective satisfaction rate of claims. The creditor – usually a business contact of the debtor – needs to take into account the impacts of broken commercial relations, failure of the supply-chain, sunk and transaction cost or the loss of future profits. At the end of the day, a preservation of business partnership may be evaluated as more advantageous than a debt collection. From the perspective of a debtor, this may serve as a sound argument to persuade creditors even to support a significant debt reduction ("haircut"), or to a debt rescheduling (e.g. with lower interest rates of lower instalments).[38] Also as Rico, Pandit and Puig proved statistically that the retrenchment of assets (tangible and intangible), inventory or labour costs (employees) are not significantly related to the probability of turnaround of enterprises.[39]

CONCLUSION

The impending insolvency can be resolved in the environment of the Czech legal system by individual bankruptcy resolution methods within a formal insolvency proceeding or by the currently being developed concept of preventive restructuring (if the Act on Preventive Restructuring is adopted as proposed).

The authors distinguish qualification criteria for both courses of actions. While insolvency law perceives impending insolvency as the minimum level of the debtor's financial difficulties required to initiate insolvency proceedings, the concept of preventive restructuring sees an impending insolvency as the maximum tolerated degree of seriousness of an entrepreneur's financial problems which are still worth the effort to avert. However, although both procedures basically aim for the same goal (i.e. to financially restore the entrepreneur and ensure the proper functioning of their business), they achieve it through diametrically different procedures.

The conclusion of authors is that the concept of preventive restructuring is capable of effectively averting impending insolvency under certain conditions. Beside statutory tests on court´s approval of the restructuring plans there are factual prerequisites on the side of debtors themselves that have to be dealt with in

[38] Noe and Wang explored a number of debts restructuring negotiation strategies with different terms and conditions. In detail see NOE, Thomas, H., WANG, Jun. Strategic Debt Restructuring. *Review of Financial Studies*. Vol. 13, No. 4, 2000, pp. 985-986.

[39] These researchers also came to an important conclusion that the debt reduction effect is amplified when aided by the "automatic stay" on individual enforcement actions. See RICO, Manuel, PANDIT, Naresh R., PUIG, Francisco. SME insolvency, bankruptcy and survival: an examination of retrenchment strategies. *Small Business Economics*. Vol. 57, issue 1, pp 118-120.

the initial negotiation phase of the preventive restructuring procedure.

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

SECTION III
COMPETITION LAW

The first reduction of the fine in the decision of the Czech Competition Authority due to the undertaking's compliance program – a step in the right direction?

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Abstract*: In early September 2022, the Czech Competition Authority (Office for the Protection of Competition) for the first time in its decision-making activity reduced the fine imposed upon a competitor due to its compliance program. This is a fundamental change, as this Office has so far refused to take the compliance program into account when considering the amount of the fine. The objective of this paper is to assess what functions a compliance program can have in competition law. Another aim is to find out what the Z-TRADE's violation of competition law was, how much the fine was reduced and under what circumstances. Related to this is the research question of whether and how the Office has defined the principles for taking this program into account in its future decision-making. In order to clarify the nature of this tool, the author has asked another research question - how the Office argued in its previous decisions for refusing to take the compliance program into account. In the Conclusion, the author assesses whether the consideration of compliance in the practice of the Czech Competition Authority is a step in the right direction. The author will use the method of qualitative analysis of jurisprudence and legal literature. While examining the links between the use of compliance in the administrative penalty for violation of economic competition and in the criminal penalty, he will use the micro-comparison method.*

Keywords*: competition law, compliance, criminal law, Czech Competition Authority, reasoning of the Czech Competition Authority, Z-TRADE case.*

INTRODUCTION

In early September 2022, the Czech Office for the Protection of Competition for the first time in its decision-making activity reduced the fine imposed to an undertaking due to its compliance programme. It was in the case of the Z-TRADE, s.r.o. limited liability company[1] This is a fundamental change, as the Office has so far refused to take the compliance program into account when considering the amount of the fine.

[1] Decision of the Czech Office for Competition file number: ÚOHS-S0365/2020/KD, reference number: ÚOHS-30580/2022/871 of September 5, 2022. [viewed 15 October 2022]. Available from: https://www.uohs.cz/cs/hospodarska-soutez/sbirky-rozhodnuti/detail-18386.html#_ftn109.

The objective of this paper is to assess what functions a compliance program can have in competition law. Another aim is to find out how the Z-TRADE competitor violated competition law, and how much the fine was reduced. Related to this the author made a research question of whether and how the Office has defined the principles for taking this program into account in its future decision-making, and whether inspiration can be drawn from the use of compliance in the criminal sanctioning of legal entities. In order to clarify the nature of this tool, the author has asked another research question - how the Office argued in its previous decisions for refusing to take the compliance program into account, and how the violators argued, on the contrary, in their proposals to have the fine reduced.

In the Conclusion, the author assesses whether the consideration of compliance in the practice of the Czech Competition Authority is a step in the right direction and whether its definitions and rules in the Z-TRADE case and in the issued principles of the Office are sufficient. The author will use the method of qualitative analysis of jurisprudence and legal literature to research these goals - due to the limited scope of this paper only with respect to selected cases and publications. While examining the links between the use of compliance in the administrative penalty for violating competition and in the criminal penalty, he will use the micro-comparison method. The article does not deal with the definitions, methods and forms of the compliance program in general, or its use in areas other than competition law.

1. NATURE OF VIOLATIONS OF COMPETITION LAW BY THE Z-TRADE UNDERTAKING

In this part of the paper, the author has met one of its goals, namely a detailed examination of violating competition law by the Z-TRADE, s.r.o undertaking (hereinafter referred to as “Z-TRADE”). The Czech Competition Authority proved that it was in the form of vertical agreements that this undertaking directly determined resale prices to its customers, which is usually referred to as "resale price maintenance". This practice was aimed at disrupting price competition between buyers to the detriment of end customers. In this way, Z-TRADE eliminated the application of possible lower prices of individual distributors to their customers. It was a market for candles and aromatic goods of a luxury nature of the trademarks Yankee Candle, WoodWick and Millefiori Milano.[2] The Z-TRADE company has only one member and was founded in 1992, but since 2011 the company Z-TRADE SK, s.r.o. has been operating in the territory of the Slovak Republic, whose sole member is the same person as in the Czech Z-TRADE undertaking. The company Z–TRADE Hungary Kft operates in the territory of Hungary, its sole member being the son of the Z-TRADE sole member.

[2] E.g. scented waxes and straws, scented sticks and pearls, aroma diffusers, plug-in scents, and car scents.

Z-TRADE operates both at the wholesale level – supplying the said goods to distributors, and at the retail level, where it sells these goods to consumers through its retail stores or its online stores. This practice distorts competition on the territory of the Czech Republic and, according to the findings of the Office[3], was capable of affecting trade between EU Member States. Therefore, in addition to the penalty for prohibited agreements pursuant to Section 3 of Act No. 143/2001 Coll., on the protection of competition, a violation of Article 101 (1) TFEU was also applied.[4] Z-TRADE had a very strong position in this product category and within the geographically defined market. Therefore, the "de minimis" exception does not apply to the assessed agreements, but this exception could not be applied in general to the affected Z-TRADE agreements, since they were target agreements.

The so-called block exception for the exemption of vertical agreements from prohibition and invalidity applies to vertical agreements, which include precisely distribution agreements as in the case under review, but also, for example, franchising agreements. However, the block exemption under this Regulation does not apply to the Z-TRADE vertical agreements.[5]

Z-TRADE committed violations of both the Czech and EU competition law between 2013 and 2020. The Czech Competition Authority proved that Z-TRADE checked and enforced if the resale prices applied by the distributors coincide with the Z-TRADE ordered prices and threatened that it would not supply its products at all if the distributors prices were lower than those set by Z-TRADE, and in individual cases it discontinued its supplies. Z-TRADE set the prices for its distributors - retailers or sales representatives either directly in the contract (e.g. the "fragrance of the month" deal in 2013) or by sending letters as part of discount events. Alternatively, distributors were obliged to follow the prices set

[3] WINKLER, Martin. Mimozmluvné záväzky v medzinárodnom obchode. In: WINKLER, Martin (ed.) *Právo v medzinárodnom obchode*. Bratislava: Wolters Kluwer SR s.r.o., 2021, 427-456. ISBN 978-80-571-0320-2.

[4] These are also agreements that affect trade between EU member states only potentially - see the Judgement of the Court of Justice of 6 March 1974. Case ZOJA, ECR 1974-00223 [online]. [viewed 15 October 2022]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:61973CJ0006.

[5] Commission Regulation (EU) No. 330/2010 of 20 April 2010 on the application of Article 101(3) TFEU to categories of vertical agreements and concerted practices (OJ L 102, 23/04/2010). According to Section 4 of the Act on the Protection of Competition No. 143/2001 Coll., as amended, this regulation on the block exemption for vertical agreements also applies to purely Czech agreements, i.e. which do not affect trade between EU member states. With effect from 1 June 2022, this regulation was replaced by Commission Regulation (EU) No. 2022/720 of 10 May 2022 on the application of Article 101(3) of the TFEU to vertical agreements and concerted practices (OJ L 134, 11 May 2022), Article 4 of which letter a) is the same as in the previous Regulation No. 330/2010. However, according to Article 4 letter a) of this Regulation does not apply to the assessed agreements under EU law and the Czech law either, because fixed or minimum price agreements applied by the competitor Z-TRADE to distributors are not exempted from the prohibition and invalidity.

in Z-TRADE´s e-shops. Although Z-TRADE presented the prices to its distributors as "recommended" ones, it enforced them - warning them by phone to make sure they would not deviate from the Z-TRADE prices.

Internal and e-mail communication, minutes of meetings, personal notes of managers, as well as the refusal of deliveries to a seller who sold the assessed goods at lower prices also testify to the set prices. These were so-called “target agreements”, where it is sufficient for the Office to prove that they were concluded with the aim of distorting competition - and there is no need to prove that these agreements were actually implemented.

2. COMPETITION COMPLIANCE IN RELATION TO COMPETITION LAW GENERALLY

The issue of compliance in the activities of the EU, its Member States, and their bodies in the event of violating law, as well as in corporate (corporate) organization and management, has been discussed for many decades. For example, de Weiler states this already in 2014 emphasising the application in competition law and practice.[6] It can be understood very broadly across structural investigations, and it can also be understood as the "world of compliance" in the activities of EU bodies, states and business corporations - its rules are based on legal norms and are always specific to the given system and entity.[7]

In 2014, the compliance management system was included in ISO 19600:2014, which is important for assessment by a state authority in administrative or criminal proceedings, whether the requirements for it are met in a given legal entity and whether the system is functional or not. Competition compliance should create positive and negative motivation in the legal entity to comply with obligations, ensure methodical management of the creation of internal rules of competitively compliant behaviour. It also includes internal education and training of employees and management of the organization, documentation and an internal communication system, including protection of whistle-blowers and internal control. Imposing sanctions in case of violating competition rules and their records are also significant. For a functional preventive and protective system of competition compliance, personnel prerequisites should also be ensured, including the necessary degree of independence - the compliance officer should not be part of or subordinate to the top management of the corporation. Competition (Antitrust) Compliance can be defined as "a fundamental and integral part of broad Corporate Compliance, which defines the system requirements for the

[6] DE WEILER, Henri. Advancing the supranational compliance debate - new directions in the enforcement of European Union law. *The Lawyer Quarterly*, 1/2014, p. 1, ISSN 1805-8396.
[7] FALKNER, G., HARTLAPP, M., TREIB, O. Worlds of Compliance: Why Leading Approaches to the Implementation of EU Legislation are only Sometimes-True Theories’. *European Journal of Political Research*, 46/2007, p. 395, ISSN 0304-413.

competitively compliant behaviour of a business corporation, continuously identifies and evaluates its competition risks and, following this, establishes specific procedures, measures and tools aimed at minimizing or completely eliminating this specific group of compliance risks."[8]

Compliance contributes to the proper enforcement of competition law, including the assessment of the proper performance of the competitor's commitments to remedy competition, which the competitor proposed during the competition law violation proceedings and which the Office accepted and imposed on them by decision. The Office then assesses the proper performance of these commitments - and could also consider a functioning compliance system if the competitor has implemented it.[9]

On compliance in general and specifically on competition compliance, see also some publications in Czech[10] and English literature.[11] Compliance in the area of intellectual property is also in many aspects close to competition compliance.[12] The prevention of law violations and the compliance system is also important when assessing the development of all efforts to prevent competition law violations in the misuse of blockchain software technology in the agenda of "smart contracts" for anonymization and hidden cartelization and thus also the degree of punishment by the competition authority.[13] Compliance is addressed from the point of view of cyber security rules, the violation of which can also be reflected in the competition.[14]

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[8] KOUKAL, Pavel. „Compliance Officer" a jeho úloha v soutěžní Compliance ("Compliance Officer" and its role in competition Compliance). *Antitrust*, 3/2016, 2017, p. 76, ISSN 1804-1183.

[9] DOSTÁL, Ondřej. Commitment decisions in practice of the European Commission in enforcing the European Union competition law in energy sector. *The Review of European Law, Economics and Politics*, 4/2017, p. 92, ISSN 1805-8809.

[10] ANDREISOVÁ, Lucie, MORAVEC, Tomáš. *Obchodní společnosti pohledem Corporate Governance*. (*Business companies from the point of view of Corporate Governance*). Praha: Grada Publishing, 2021, ISBN: 978-80-2711-217-3. Also, HURYCHOVÁ, Klára, SÝKORA, Michal. *Complience programy (nejen) v České republice. (Compliance programs (not only) in the Czech Republic)*. Praha: Wolters Kluwer/ASPI, 2018, p. 15, ISBN: 978-80-7552-667-0.

[11] BARTOW, J., T., BIEGELMAN, M., T. *Executive roadmap to fraud prevention and internal control: creating a culture of compliance.* Hoboken: John Wiley & Sons, 2012. ISBN: 978-1-118-00458-6. Also, BIEGELMAN, M., T. *Building a world-class compliance program: Best practices and strategies for success*. New Jersey: John Wiley & Sons, Inc., 2008. 298 s. ISBN: 978-0-470-11478-0.

[12] ANDREISOVA, Lucie. Programy compliance z pohledu ochrany a vymáhání práv duševního vlastnictví. (Compliance programs from the point of view of protection and enforcement of intellectual property rights). *Obchodní právo. (Commercial law)*, 2/2019, p. 2, ISSN 1210-8278.

[13] BEJČEK, J. Chytře protiprávní "chytré" smlouvy. Mezi efektivností smluvní agendy a zakódovanou protiprávností zejména v ochraně soutěže. (Cleverly illegal "smart" contracts. Between the effectiveness of the contractual agenda and the coded illegality, especially in the protection of competition). *Právník. (Lawyer)*, 5/2020, s. 377, ISSN 0231-6625.

[14] VOSTOUPAL, Pavel. Certifikace kyberbezpečnostních technologií. (Certification of cyber security technologies). *Revue pro právo a technologie (Review of Law and Technology)*, 20/2019, p. 147, ISSN 1804-5383 https://doi.org/10.5817/RPT2019-2-5.

The creation and use of compliance programs is not limited only to business corporations, they are also important in the prevention of the public authorities against their distortion competition without justifiable reasons according to Section 19a of the Czech Act on the Protection of Competition. About such aspects referred this conference last year – Lapšanský in his paper mentioned that the Czech Competition Authority witnessed a number of irregularities linked to the performance of public contracts. It is also the task of the Slovak Office to intervene against anticompetitive behaviour linked to the public authorities.[15]

3. ARGUMENTATION IN PREVIOUS AUTHORITY DECISIONS REFUSING TO CONSIDER COMPLIANCE IN PENALTY MITIGATION

In the Z-TRADE case, the Czech Competition Authority deviated from its previous practice for the first time. This was reflected in the Office's decision in the case of manipulating a small-scale public contract "Ensuring the transfer of data and information in the territorial self-government of the statutory city of Přerov" by a bid rigging cartel of consulting companies. The business corporations involved in the prohibited agreement were proven to have committed an offence, fined and prohibited from further execution of the public contract, and therefore filed an appeal against the Office's decision. In its appeal, the Erste Grantika Advisory company applied its compliance system as "an exculpatory ground and thus made every effort that could be required to prevent the breach of legal obligation."[16]

However, the Office rejected the proposal, saying that "what constitutes a 'reward' for this effort is precisely eliminating competition law violations. The creation of such a compliance program is not, nor can it be, perceived as a reason for liberation. Then, instead of preventing and positively influencing the observance of competition law, the compliance program would function as a 'universal alibi', and its creation would lead to a completely opposite result."[17] The Office also argued with the case of the General Court of the Court of Justice of the EU.[18] According to this case law, the Compliance program is generally not

[15] LAPŠANSKÝ, Lukáš. *Slovak national regime of the protection against anticompetitive interventions by public authorities*. In ŠKRABKA, Jan and Nicole GRMELOVÁ (eds.). 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. Bucarest, Paris, Calgery: Adjuris 2021. ISBN 978-606-95351-1-0.

[16] Decision of the Chairperson of the Office for the Protection of Competition File no.: ÚOHS-R72,74,75,78/2019/HS-34912/2019/310/HMk In Brno 17/12/2019 [viewed 15 October 2022]. Available from: https://www.uohs.cz/cs/hospodarska-soutez/sbirky-rozhodnuti.html.

[17] Decision of the Chairperson of the Office for the Protection of Competition File no.: ÚOHS-R72,74,75,78/2019/HS-34912/2019/310/HMk In Brno 17/12/2019 [viewed 15 October 2022]. Available from: https://www.uohs.cz/cs/hospodarska-soutez/sbirky-rozhodnuti.html.

[18] Judgment of the Judgment of the Court of First Instance (Second Chamber) of 12 December 2007 in joint cases BASF AG (T-101/05) and UCB SA (T-111/05) v Commission. [viewed 15 October 2022]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62005

guaranteed only as an exculpatory reason, but its existence does not grant the competitors the right to have it taken into account as a mitigating circumstance when imposing fines for their illegal acts.

Another case in which the Office refused to take the compliance program into account in 2022 was the cartel agreement of several legal entities manipulating a public contract "Development of e-Government services in the Olomouc Region". Here too, the ICZ company - one of the participants in the agreement affected by the fine - requested in its appeal that "as part of the assessment of extenuating circumstances, when imposing a fine in 2022, the long-term effort ... for preventive, reactive and control measures of Competition Compliance should be taken into account".[19]

The Chairperson of the Office argued that "circumstances existing at the time of imposing the fine ... do not in any way indicate the circumstances existing at the time the administrative offense was committed. At the same time, the legislator defined quite clearly that the Office must take into account 'the circumstances under which the administrative offense was committed'. According to the Chairperson of the Office, the procedure of the Office fairly did not reflect ICZ's efforts to continuously educate employees in the field of competition and to set up preventive, reactive and control measures and mechanisms as a mitigating circumstance, since it did not occur at the time of committing the offense."[20]

When considering compliance in administrative punishment from the point of view of a possible mitigation of the sanction, the Office proceeds in accordance with Section 22b (1), first sentence of the Act on the Protection of Competition. Within the meaning of this Section, the Office shall take into account the seriousness of the offense, in particular the manner of its commission and its consequences, and the circumstances under which the offense was committed.

TJ0101&qid=1666549831237. Point 52 of the Judgement states: "Regarding the measures taken by BASF in order to prevent repeated illegal acts, it must be stated that regardless of the importance of the measures to achieve compliance with competition law, this fact does not change the existence of the detected illegal act. The adoption of a program of compatibility with the competition rules by the undertaking concerned does not therefore constitute an obligation on the part of the Commission to grant it a reduction of the fine based on this circumstance." Likewise Judgment of the Court of First Instance (Fourth Chamber) of 15 March 2006 in case BASF AG v Commission (T-15/02). [viewed 15 October 2022]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62002TJ0015&qid=1666551683070. According to this judgement the Commission is not obliged to take into account the existence of a compliance program when imposing a fine.

[19] Decision of the Chairperson of the Office for the Protection of Competition on appeal, file number: ÚOHS-R0011,0012,0013,0014,0017,0018/2022/HS, No. Brno ÚOHS-12259/2022/164 dated 12 April 2022 [viewed 15 October 2022]. Available from: https://www.uohs.cz/cs/hospo darska-soutez/sbirky-rozhodnuti.html.

[20] Decision of the Chairperson of the Office for the Protection of Competition on appeal, file number: ÚOHS-R0011,0012,0013,0014,0017,0018/2022/HS, No. Brno ÚOHS-12259/2022/164 dated 12 April 2022 [viewed 15 October 2022]. Available from: https://www.uohs.cz/cs/hospo darska-soutez/sbirky-rozhodnuti.html.

However, the second sentence of this provision establishes room for some mitigation: "Furthermore, the actions of a legal entity or a public administrative body during proceedings before the Office and their efforts to eliminate the harmful consequences of the offense shall be taken into account."

4. CONSIDERATION OF COMPLIANCE TO REDUCE THE FINE IN THE DECISION OF THE COMPETITION AUTHORITY IN THE Z-TRADE CASE

The Office fined Z-TRADE for prohibited vertical agreements in which it fixed resale prices to its distributors and retailers and determined its amount with regard to the amount of the infringer's sales and the legal rate of 10 per cent of the net turnover. The company violated not only Czech competition law – Section 3 (1) of the Czech Act on the Protection of Competition but, simultaneously, Article 101 (1) TFEU, while the Office considers the violation of EU law to be primary. The Czech Competition Authority considered the mitigating circumstances – already applied sanctions against customers who sold at a lower price, voluntary termination of imposing sales prices by the Z-TRADE company in 2020 and informing its business partners that its prices are really only recommended. Z-TRADE has modified its contracts so that they do not conflict with EU competition law. The Office set the basic amount of the fine at CZK 22,061,000 (an equivalent of EUR 882,000).

However, Z-TRADE admitted to the violation of competition law and requested a reduction of the fine within the statutory time limit as part of the settlement procedure.[21] Since the conditions for the settlement were met, the Office reduced the fine due to the settlement by 20 per cent to CZK 17,649,000. As a part of this reduction, the Office also took into account the fact that the violator

[21] Under Section 22ba (2), (6) Act No. 143/2001 Coll., on the Protection of Competition, as amended, the Office will reduce the company's fine, the amount of which was notified to the participants of the proceedings in the statement of objections, by 20 per cent. The condition for reducing the fine is that the Office found the undertaking guilty from a misdemeanor (in the case it was the agreement distorting competition) and the undertaking has confessed to the misdemeanor. Another condition is that the Office deems such a penalty sufficient in view of the seriousness and nature of the misdemeanor. This procedure is referred to as "settlement", for which the company must submit a request within 15 days of the notification of objections. As a soft law, this legal provision is supplemented by the Notice of the Czech Competition Series dated 8 November 2013 on the procedure aimed at speeding up the course of administrative proceedings by using the institution of a request for reducing a fine under Section 22ba (2) of the cited Act (settlement procedure) [viewed 15 October 2022]. Available from: https://www.uohs.cz/en/legislation.html. Under Section 21h (5) of the Act the Office proceeds in accordance with this Czech regulation even in proceedings with an EU element. In the soft law of EU law, settlement is governed by the Commission's Notice on the settlement procedure with the aim of adopting a decision pursuant to Articles 7 and 23 of Council Regulation (EC) No. 1/2003 in cases of cartels. See the Official Journal 2008/C 167, dated 2.7.2008, p. 1 as amended Notice of the Commission Official Journal (2015/C 256/02) dated August 5, 2015. [viewed 15 October 2022]. Available from: https://eur-lex.europa. eu/.

documented the implementation its compliance program. In relation to the functioning of competition on the defined relevant market, the nature and type of goods, the business model and the size of the competitor, the Office considers Z – TRADE to be sufficiently effective and refers in detail to some parts and annexes of the file.

In the decision, the Office stated a double reduction – for the aforementioned extenuating circumstances and then for the implementation of the compliance system, but did not state the percentage reduction for each of these reasons. These percentage rates are anonymized for Z-TRADE trade secrets. Unfortunately, the decision does not even state and assess in more detail what the compliance system consists of and why the Office changed its previous negative approach to this mitigating reason.

5. PRINCIPLES FOR CONSIDERING THE COMPLIANCE PROGRAM IN THE AUTHORITY'S DECISION-MAKING

In connection with its first decision to consider the compliance program for administrative punishment of infringements of competition law, the Office has published the principles of taking the compliance program into account on its website. In these principles, the Czech Competition Authority expresses that it is aware of the importance of prevention in competition and therefore decided to start appreciating the efforts of undertakings for implementing Compliance programmes. It also defines the term "compliance programs in the field of competition" as "sets of preventive measures, the aim of which is to raise awareness of competition law and potentially problematic conduct consisting of a possible violation of competition rules with measures to avoid it, at all levels of the company, i.e. from rank-and-file employees to middle and upper management."[22]

The condition of compliance as a mitigating circumstance will be the successful application of the settlement procedure (the Office links compliance with it), the sufficiency of the program with regard to the type of market and market power of the undertaking and, in the case of already established compliance, that the violation of the competition occurred without the knowledge of the statutory bodies or other management of the undertaking. Although the Office will take into account already existing and newly introduced programs, as a relief it will emphasize already established programs of sufficient quality before their implementation only in response to the Office's investigation. It will not take into

[22] Consideration of the compliance program [accessed from the website of the Office, News from the competition, 15 October 2022] Available from: https://www.uohs.cz/cs/hospodarska-soutez/zakazane-dohody/zohledneni-compliance-programu.html.

account the purely formal Compliance programmes which do not introduce effective measures and control.[23]

6. CRIMINAL PUNISHMENT OF LEGAL PERSONS AND COMPLIANCE AS AN INSPIRATION FOR THE COMPETITION AUTHORITY?

In criminal law, the violation of competition is punished under Section 248 of the Criminal Code. While its paragraph 1 regulates the criminal penalty for unfair competition, paragraph 2 governs the criminal penalty for agreements distorting competition.[24] However, this penalty is very narrow. As far as unfair competition is concerned, the provision refers only to its so-called factual bases under Sections 2977-2987 of the Czech Civil Code. It does not apply to the so-called judicial or unnamed factual bases, the sanction for which is based only on the general clause of unfair competition enshrined in Section 2976 of the Czech Civil Code. In any case, the given case of Z-TRADE is not qualified as anti-competitive behaviour and this regulation does not apply to it.

Regarding the criminal sanction for agreements distorting competition, it would be possible to consider the application of this provision, since the vertical agreement that Z-TRADE concluded with its distributors falls within the scope of agreements distorting competition. However, the cited provision of Section 248 (2) the Czech Criminal Code refers to the so-called cartel agreements, i.e. agreements in horizontal competition (according to the prevailing interpretation of the wording of this provision, "they shall enter into an agreement with their competitors").[25] These agreements are concluded between competitors – undertakings in the same or similar position in the economic process (e.g. between producers of a given product, between providers of the same or interchangeable service, between wholesalers, between retailers, between researchers institutions, etc.). However, vertical agreements do not belong to them, because vertical competition, in contrast, takes place between undertakings operating at different stages of the economic process (e.g. between producer of the final product and manufacturer of its components, between manufacturer and trader, between wholesaler and retailer, between manufacturer and research institution, etc.). Therefore, even this criminal law provision does not apply to the case under consideration.

However, there is another limitation for competitors who would commit a vertical agreement - the criminal penalty according to the Czech Criminal Code

[23] Consideration of the compliance program [accessed from the website of the Office, News from the competition, 15 October 2022] Available from: https://www.uohs.cz/cs/hospodarska-soutez/zakazane-dohody/zohledneni-compliance-programu.html.
[24] Provision of Section 248 of the Czech Criminal Code, Act No. 40/2009 Coll., as amended.
[25] KINDL, J. at al. *Soutěžní právo (Competition Law).* 3. vydání (edition). Praha: C. H. Beck, 2021, ISBN 978-80-7400-806-1.

generally applies only to people - natural persons. However, in the field of violating cartel law, the direct participants in these agreements are mostly legal entities, which are usually much stronger in terms of capital in competition than natural persons. That was also the case with Z-TRADE. In addition, for a criminal penalty to be imposed for violating Section 248 (2) of the Czech Criminal Code, it is necessary to prove that the perpetrator acted intentionally. There is no need to prove intention for the punishment of an administrative offense under Section 21 (2) Act No. 143/2001 Coll., as the Office stated in point 72 of the decision in the Z-TRADE case (see above for the citations thereof), but at the same time the Office proved in points 73-77 of this decision that Z-TRADE's actions were intentional.

However, the offender can ask the Office in administrative proceedings for a settlement procedure, and the Office can accept it and reduce its fine, if the offender confessed to its illegal act as part of the settlement procedure. However, if the perpetrator of the cartel confessed to the Competition Authority and the criminal court obtains its confession from the Authority as evidence against the offender, this could generally lead to its easy prosecution by the criminal court. Therefore - so that the fear of criminal punishment does not prevent them from submitting a request for settlement confessing its illegal conduct, the amendment of the Czech Criminal Code was supplemented by provision of Section 248a thereof. Under that provision, a request for leniency or for settlement and confession as well as communication of data about the commission of its crime is understood as effective remorse and termination of criminal responsibility.

Vertical agreements are concluded in the vast majority between legal entities, which under Section 248 (2) of the Czech Criminal Code, are not punishable under this Act, as mentioned above. Therefore, only the Act on Criminal Liability of Legal Entities comes into consideration.[26] However, even according to this law, legal entities are not criminally liable for a vertical agreement. In Section 7 of this Act, agreements with a competitor were expressly excluded from criminal penalty pursuant to Section 248 (2) of the Czech Criminal Code. In principle, with the small exception of agreements manipulating public procurements according to Section 257 of the Criminal Code,[27] only natural persons and not legal entities can be prosecuted for the violation of competition in the Czech Republic, and it is therefore not possible to consider mitigating their criminal penalty if the offender has implemented an effective compliance program.

Nevertheless, the research question covering this part of the paper asks, whether the Czech Competition Authority can be inspired by the legal regulation

[26] Act No. 418/2011 Coll., on the criminal liability of legal entities and proceedings against them (TOPO), as amended.

[27] However, the exclusion of legal entities and effective remorse in Section 7 TOPO do not apply to a possible cartel agreement distorting a public contract under Section 257 of the Czech Criminal Code - the so-called big rigging - which, of course, was not the case with Z-TRADE.

and the way of assessing the compliance program in other cases of criminal sanctioning of legal entities, than in the case of cartel agreements, when imposing administrative penalties on legal entities for violation of competition law.

Compliance was introduced into the Czech Criminal Law by the Act on Criminal Liability of Legal Entities as a reason for reducing the penalty for legal entities. This tool was introduced by a 2016 amendment, namely to the wording of Section 8 (5) of the cited Act.[28] The list of persons in Section 8 (1) of the cited Act includes "statutory bodies of a legal entity, other persons in a leading position, persons with significant influence on its management and an employee or a person in a similar position, if their actions can be attributed to the legal entity committing a criminal act." According to the interpretation (and the purpose and meaning of the amendment), the implementation of an effective compliance program in the organization and activities of a legal entity is considered to be the exercise of "every effort" in the sense of the aforementioned amendment, Section 8 (5).[29]

Thus, in the case of a criminal offense of a legal entity, the compliance program can lead law enforcement authorities to reduce the penalty and is thus of great importance for its further possible business activity. The practice of criminal courts in punishing the so-called collusion in manipulating public procurements according to Section 257 of the Criminal Code can be the closest to inspire the Czech Competition Authority in considering compliance when administratively punishing violations of the Act on the Protection of Competition. These often occur by concluding anti-competitive agreements (including vertical ones) of the bid rigging type between potential or current participants in public procurements. In these cases, not only natural persons but also legal entities are criminally punished (Section 257 is not exempt from the Act on the Criminal Liability of Legal Entities).

One of the first cases when the criminal court considered this was the criminal punishment of the Governor of the Central Bohemian Region, MUDr. David Rath, and several other medical doctors or other persons in leading positions of participating hospitals or supplier organizations as well as legal entities involved in corruption and manipulation of public contracts. At the same time, the defendant business company Hospimed proved that it had already implemented a certified, controlled and enforceable compliance management system including competition law in the area of public procurement. All employees, executives and members of the statutory bodies were trained for it, and their activities were monitored by internal and external independent auditors, including detected violations and corrective measures.

However, the Regional Court rejected its arguments about compliance

[28] Act No. 183/2016 Coll. amending the Act on Criminal Liability of Legal Entities.

[29] SEIFERT, Philip. Fundamental changes to the Act on TOPO (criminal liability of legal entities). Legal space [online], 2016. [viewed 15 October 2022]. Available from https://www.pravnipro stor.cz/clanky/trestni-pravo/zasadni-zmeny-zakona-o-T-O-P-O-podzim-2016.

and the request for a reduced sentence. According to the court decision, "the mere existence of, for example, a so-called compliance system or code of ethics within the defendant legal entity and proof of familiarization among even members of its statutory bodies, cannot lead to the acquittal of the defendant legal entity from criminal liability under Section 8 (5) TOPO, if these persons actually decide on the adoption of such measures, and at the same time they are to supervise their compliance. If they themselves violate them by committing a criminal act, they deny the very purpose of these measures. If the actions of a statutory body or a manager of a legal entity are in conflict with compliance measures, the application of Section 8 (5) TOPO comes into consideration absolutely exceptionally. The unlawful actions of these persons oppressing a legal entity constitute its will, its own actions."[30]

CONCLUSION

It generally follows from the scholarly literature that competition compliance is a tool for preventing competition law violations and can be considered as a reason for reducing penalties by both the criminal courts and the competition authorities. The Office's consideration of the compliance program in the case of Z-TRADE, as well as the publication of the principles of its use as a mitigating circumstance when punishing a violation of competition law, should be welcomed as a fundamental change in the practice of the Office and a step in the right direction. In the landmark Z-TRADE decision, the Office stated a percentage reduction of the fine specifically for reasons of compliance (compared to other extenuating circumstances), but it did not publish this percentage on its website as part of the publication of this decision and marked there this data as a trade secret.

However, for the greater legal certainty and information of competitors, it would be more appropriate to state the specific percentage rate by which the Office reduced the fine. The positive thing is that at the same time the Office published on its website the principles for the implementation of which compliance programs will be taken into account and ruled out that they would not take into account only formal programs or a situation where competition law was violated with the knowledge of the competitor's management, even though the management was part of the compliance program and properly trained. The Czech Competition Authority can draw inspiration from legal literature and criminal court jurisprudence regarding the conditions for taking compliance into account in its practice. Especially because, with the exception of agreements manipulating public contracts, criminal sanctions against legal entities for violation of competition law are not possible in Czech law, and administrative punishment by the

[30] Decision of the High Court in Prague (acting as a court of appeal) of 26 June 2019, File No. 6 To 64/2018 – 34 994 [viewed 15 October 2022] Available from: https://www.aspi.cz/products/ search. Decision of the Regional Court in Prague 4, File No. T 42/2016 of 31 January 2020 [viewed 15 October 2022] Available from: https://www.aspi.cz/products/search.

Office replaces it. The Office should have taken inspiration from this jurisprudence with full consideration of the positive preventive effect of compliance on competition practice, but at the same time excluding its consideration in the case of misuse in illegal actions by violators.

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Exclusivity clause in lease agreements for commercial premises from the perspective of Slovak and European competition law

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Abstract: *A relatively frequent practice when concluding lease agreements for commercial premises in shopping centres is the tenants' requirement towards lessors for so-called exclusivity, i.e. the requirement not to lease commercial premises in the same shopping centre to their competitors or vice versa – the landlords' requirement towards tenants to include a so-called radius clause in lease agreements, where the tenant may not conclude a lease agreement for another commercial premise in a certain area within a specified distance from the shopping centre. In this paper, we look at this issue from a competition law perspective. A lease agreement with an exclusivity clause or radius clause may fulfil the defining features of an agreement restricting competition, which is prohibited under Article 101 of the Treaty on the Functioning of the EU and Section 4 of Slovak Act No. 187/2021 Coll. on the protection of economic competition. Although the courts in the Slovak Republic have not yet dealt with this issue, it has become the subject of judicial review of decisions of antimonopoly offices in other European countries and also the Court of Justice of the EU has entered into the valid legal regulation with its decisions. The aim of this paper is to define, after an analysis of the valid legal regulation and the case-law in several European countries and of the Court of Justice of the EU, the criteria under which lease agreements with exclusivity clause may be considered to be in compliance with European and Slovak law.*

Keywords*: agreement having as its object the restriction of competition, agreement having the effect of restricting competition, agreement restricting competition, exclusivity clause, lease agreements for commercial premises, radius clause.*

INTRODUCTION

In the practice when leasing commercial premises in shopping centres, it is a frequent requirement of tenants towards landlords to ensure so-called exclusivity, i.e. that the landlord does not rent its premises in the same shopping centre to another tenant who would sell goods or provide services competitive to their own goods and services. They seek to ensure that visitors to the shopping centre have the opportunity to purchase certain products or services exclusively or largely only from them. There are also cases of partial exclusivity, e.g. that other tenants within the shopping centre may include in their peripheral range of offerings certain products, but no more than covering a certain part (e.g. 200 m²) of the sales area of the shopping centre concerned; to a greater extent only with the consent of the respective tenant. The sanction for breach of such an obligation by

the landlord is usually a contractual penalty, a discount on the rent, the tenant's right to withdraw from the lease or a combination thereof. Landlords are usually willing to comply with such a request from tenants, especially if they have a strong potential to attract clients (so-called anchor tenants).[1]

However, exclusivity in lease agreements can also be of the exact opposite nature. It may consist in a landlord's requirement that a tenant does not open another shop within a certain radius of a shopping centre owned by the landlord.[2] We are talking about so-called radius clauses.[3] This radius can range from a few hundred metres to several tens of kilometres. The sanction, as in the case of the previous clause, may be the landlord's right to withdraw from the lease agreement or to demand payment of a contractual penalty.

The application of one or the other model depends on which of the parties is in a stronger position when concluding the lease agreement and can therefore determine the terms – whether it is the tenant or the landlord. Exclusivity provisions also make economic sense.[4] Thus, it would seem to be a win-win principle, where both parties are satisfied with the negotiated terms – in the first case of the exclusivity clause, the landlord gets a stable and creditworthy tenant and the tenant gets an exclusive position in the shopping centre with respect to the goods and services it offers; in the second case of the radius clause, the landlord gets a competitive advantage over other shopping centres in a unique range of goods and services, and the tenant gets a sales space in such a shopping centre. Nevertheless, there is a potential problem from the competition law point of view – it may be an agreement restricting competition, which is prohibited in the Slovak Republic under Act No. 187/2021 Coll. on the Protection of Competition and on Amendments and Additions to Certain Acts (hereinafter referred to as the "APC"), as well as in the European Union under the Treaty on the Functioning of the European Union (hereinafter referred to as the "TFEU"). We will look at this issue in more detail below.

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[1]About this concept, see STEELE, Elisabeth: The Shopping Center Radius Clause: A Candidate for Antitrust. *Southwestern Law Journal.* 1978, 32 (3), p. 827. Similarly, EPPLI, Mark; BENJAMIN, John: The evolution of shopping center research: A Review and Analysis [online]. *Journal of Real Estate Research*, 1994, 9 (1), p. 5 [30 Sep. 2022]. Available from: https://www.tandfonline.com/doi/abs/10.1080/10835547.1994.12090737.

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[3]Ibid. Similarly STEELE, Elisabeth: The Shopping Center Radius Clause: Candidate for Antitrust. *Southwestern Law Journal.* 1978, 32 (3), p. 826. In Czech Republic e.g. DUDEK, Miroslav: Konkurenční či jinak omezující ujednání. *Stavitel*. 2018, 26 (6-7), p. 60.

[4]For more details see DEGRABA, Patrick; POSTLEWAITE, Andrew: Exclusivity Clauses and Best Price Policies in Input Markets. *Journal of Economics & Management Strategies*, 1992, 1 (3), p. 428.

1. EXCLUSIVITY CLAUSES IN SLOVAK LAW AND IN OTHER NATIONAL LAWS

In the Slovak Republic, the APC is conceptually based on the provisions of Articles 101-106 TFEU. According to Section 4(1) of the APC (similarly to Article 101(1) TFEU), "an agreement restricting competition is an agreement between undertakings, a concerted practice of undertakings and a decision of an association of undertakings which has as its object or may have as its effect the restriction of competition." An agreement restricting competition shall be prohibited unless otherwise stipulated by APC (TFEU)[5].

According to Article 4(3) of the APC (similarly to Article 101(1) TFEU), "prohibited is an agreement restricting competition which consists in:

a) directly or indirectly fixing the prices of goods or other trading conditions,
b) a commitment to restrict or control production, sales, technical development or investment,
c) sharing the markets or sources of supply,
d) a commitment of the parties to apply different conditions to individual undertakings for identical or comparable performance which put or may put those undertakings at a competitive disadvantage,
e) conditioning the conclusion of contracts by requiring the parties to enter into additional commitments which are unrelated in nature or according to commercial practice to the subject matter of those contracts; or
f) the coordination of undertakings in a public procurement, a commercial tender or any other similar competition, in connection therewith."

However, according to Section 4(2) APC, an agreement between undertakings, a concerted practice of undertakings and a decision of an association of undertakings shall not constitute an agreement restricting competition if its effect on competition is negligible. The effect is negligible if the market shares of the respective undertakings do not exceed the thresholds laid down by a generally binding legal regulation. On the other side, the effect on competition shall not be considered as negligible if an agreement between undertakings, a concerted practice between undertakings or a decision by an association of undertakings has as its object the restriction of competition.

Section 4(4) APC (similarly to Article 101(3) TFEU) provides for exemptions and Section 4(5) APC for block exemptions from the prohibition of agreements restricting competition.

A lease agreement which prohibits the landlord (even under sanction of

[5] See NOVÁČKOVÁ, Daniela, VNUKOVÁ, Jana, Competition issues including in the international agreements of the Eropean Union, *Juridical Tribune - Tribuna Juridica*, 2021, 11 (2), p. 242.

a contractual penalty) from entering into another lease agreement with a competitor of the tenant, or prohibits the tenant from entering into another lease agreement with a competitor of the landlord, undoubtedly meets the conceptual characteristics of an agreement restricting competition within the meaning of Article 4(1) of the APC (similarly of Article 101(1) TFEU). However, the crucial question to be assessed in this context is whether:

- the agreement has as its object the restriction of competition (in which case it is prohibited *per se*, unless it is covered by a statutory exemption); or
- the agreement has only the effect of restricting competition (in which case, in addition to the statutory exemptions mentioned above, it is also covered by the exemption under which an agreement is not restrictive of competition if its effect on competition is negligible – Section 4(2) APC).

To assess some of the above issues, in particular to determine whether the effect of an agreement restricting competition is negligible, in the Slovak law we have an Antimonopoly Office Decree No. 188/2021 Coll. establishing thresholds for determining whether an agreement between undertakings, a concerted practice of undertakings or a decision of an association of undertakings has an insignificant effect on competition (hereinafter referred to as "AO Decree"). According to Section 1(1)(b) of the AO Decree, "an agreement between undertakings (...) has a negligible effect on competition if the market share held by each of the parties (...) to the agreement between non-competitors does not exceed 15 % on any of the relevant markets affected by the agreement between non-competitors." Similarly, under the AO Decree, competition on the relevant market affected by the agreement between undertakings is restricted by the cumulative effect of agreements between undertakings which contain a similar type of restriction of competition and which lead to similar effects on that relevant market, and those agreements between undertakings cover more than 30 % of that relevant market, and the market share held by each of the parties to the agreement between non-competitors does not exceed 5 % on any relevant market affected by the agreement between non-competitors (Article 1(1)(d)(2.)).

The Slovak authorities have not yet addressed the question of the legal nature of exclusivity in the lease agreement. The Supreme Court of the Slovak Republic has issued a number of judgments reviewing decisions of the Antimonopoly Office on cartel agreements, but none of them concerned the exclusivity clause, let alone in a lease agreement.[6] Therefore, it is also difficult to predict

[6]See, e.g. judgments of the Supreme Court of the Slovak Republic, Case No. 8Sžhpu/4/2013 of 26 February 2015, Case No. 8Sžhpu/1/2013 of 26 February 2015, Case No. 3Sžhpu/1/2013 of 9 June 2015, Case No. 2Sžhpu/1/2014 of 20 May 2015, Case No. 2Sžhpu/1/2013 of 25 February 2015, Case No. 5Sžh/2/2015 of 2 November 2016 etc.

whether it would consider them from a formalistic or an economic perspective.[7] However, there is a quite recent decision from the Czech Republic, where the Office for the Protection of Competition *(Úřad na ochranu hospodářské soutěže – ÚOHS)* in the case of company Via FAOC s.r.o.[8] did not consider as restricting competition a radius clause *(rádiusová doložka)* consisting in the obligation of some tenants – in case they open another outlet store in a geographical radius of 40 km from the shopping centre with which they have concluded a lease agreement – to pay as a sanction an increased rent. The Office found that the number of tenants restricted by the radius clauses was too small to conclude that they led or were likely to lead to a restriction of competition.[9] While the Office found negative effects of the radius clauses on competition, this was not to the extent that it was relevant.[10] However, it is conceivable in the future that a more significant use of radius clauses (and presumably also of exclusivity clauses seeked by tenants) could lead to the opposite conclusion.

In Germany, the Federal Cartel Office *(Bundeskartellamt)* has banned factory outlet centres from using radius clauses *(Radiusklausel)* in contracts with their tenants if they exceed a linear distance of 50 km.[11] The factory outlet centre originally used a radius clause for a distance of 150 km. However, in the view of the Federal Cartel Office, such a clause is neither necessary nor appropriate for the performance of the lease agreements. It regarded it as an agreement having as its object the restriction of competition between the outlet centre and its competitors and therefore prohibited the outlet centre from using radius clauses of more than 50 km in the future and from applying the already agreed clauses to existing tenants. The decision is final, as the party's appeal to the Federal Court of Justice *(Bundesgerichtshof)* was dismissed by its decision of 7 June 2016.[12]

In Austria, the Federal Competition Office *(Bundeswettbewerbsbehörde)* ruled on a case where the operator of an outlet centre had a radius clause *(Radi-*

[7]For more details see KALESNÁ, Katarína: Formalistický v. ekonomický prístup k aplikácii súťažných pravidiel. In.: VOZÁR, J.; ZLOCHA, Ľ. (eds.): *Aktuálne trendy v oblasti práva hospodárskej súťaže. Zborník z domácej vedeckej konferencie organizovanej dňa 4.12.2017 Ústavom štátu a práva SAV v Bratislave*. Bratislava: Ústav štátu a práva SAV, 2017. pp. 14 et al. Available from: https://usap.sav.sk/documents/publications/zbornik-aktualne-trendy-v-oblasti-hospodarskej-sutaze-2017.pdf.

[8]Decision of the Office for the Protection of Competition No. ÚOHS-S0041/2017/KD-34510/2019/820/AKu of 13.12.2019, which entered into force on 31.12.2019. Available from: https://www.uohs.cz/cs/hospodarska-soutez/sbirky-rozhodnuti/detail-16509.html [30. 9. 2022].

[9]Para. 179 of the Decision.

[10]Para. 182 of the Decision.

[11]Decision B1-62/13 of 26.2.2015 VR Franconia GmbH, Wertheim. Available from: https://www.bundeskartellamt.de/SharedDocs/Entscheidung/DE/Entscheidungen/Kartellverbot/2015/B1-62-13.pdf?_blob=publicationFile&v=3 [30. 9. 2022].

[12]BGH Beschluss vom 7.6.2016 (KVZ 53/15). Available from: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&nr=75406&pos=0&anz=1 [30.9. 2022].

usklausel) in its lease agreements prohibiting its tenants from operating commercial premises in any other outlet centre within a radius of 50 km.[13] The decision was subject to judicial review. The Austrian Supreme Court *(Oberste Gerichtshof)*[14] examined the radius clause from the point of view of its effect, i.e. whether and to what extent it restricts the possibilities of third parties to enter the market or to expand their market shares. The Court concluded that it did not constitute an illegal agreement, arguing in particular that the relevant market is not limited to shopping centres but also to other larger shopping premises in the respective area, and also referred to factors which play a role in a buyer's decision to visit a shop, such as location, image, parking facilities and high customer frequency. The market share of the challenged outlet centre operator thus came out to be only around 15%.[15]

In the UK, the Supreme Court in a recent decision concerning the ordinary exclusivity clause in *Peninsula Securities Ltd v. Dunnes Stores (Bangor) Ltd.*[16], moved away from considering competition restricting agreements under the earlier concept of "pre-existing freedom" (i.e. whether the parties have voluntarily restricted their pre-existing rights) to the "trading society" concept of assessing whether the agreement has "(...) become part of the accepted machinery of a type of transaction which is generally found acceptable and necessary, so that instead of being regarded as restrictive they are accepted as part of the structure of a trading society".[17] Such a pragmatic approach differs from that of the courts in continental Europe, but leads to very similar results.

Of course, each case was unique, but we would find certain common features in the decision-making of the national authorities:

- formal – it is examined whether the clause aims at restricting competition and if so, the clause is prohibited;
- material – the intensity of the negative impact on competition of the clause in question is examined and if it is sufficiently intense, it is prohibited, otherwise it is allowed.

[13]BWB/M-204 Radiusklausel z 30. 7. 2008 et al. Available from: https://www.bwb.gv.at/kartelle _ marktmachtmissbrauch/entscheidungen/detail/bwbm-204-radiusklausel [30. 9. 2022].

[14]OGH Beschluss 16 Ok 8/10 vom 12. 12. 2011. Available from: https://www.ris.bka.gv.at/ Dokumente/Justiz/JJT_20111212_OGH0002_0160OK00008_1000000_000/JJT_20111212_OGH0002_0160OK00008_1000000_000.pdf [30. 9. 2022].

[15]For more details see BARBIST, Johannes: Radiusklausel IV – Zur wettbewerbsbeschränkenden Wirkung einer Radiusklausel. *Österreichische Blätter für Gewerblichen Rechtsschutz und Urheberrecht, 2012, 61 (3), pp. 129-138.*

[16][2020] UKSC 36; [2020] 3 W.L.R. 521.

[17]For more details see KWOK, Kelvin Hiu Fai: Land-related Restrictive Covenants in Restraint of Trade. *Law Quarterly Review* 2021, 193 (58), p. 3, [online]. Available from: https://ssrn.com/abstract=3803042 [30. 9. 2022].

2. EXCLUSIVITY CLAUSES IN LEASE CONTRACTS AND EU LAW

The TFEU contains the basic legal framework for competition restrictive agreements. The relevant provisions were mentioned in the previous chapter in the context of the interpretation of the Slovak law. However, a fundamental interpretative position on these provisions was adopted by the Court of Justice of the European Union (hereinafter referred to as "CJEU") in its judgment in SIA Maxima Latvija v Konkurences padome[18]. Here, the CJEU dealt for the first time with the issue of exclusivity in lease agreements, the subject of its assessment being the exclusivity clause seeked by the tenant (i.e. Maxima Latvija, which, as a food retailer, had the status of an anchor tenant). This case follows the earlier Delimitis case decided by the CJEU, which concerned the assessment of certain forms of exclusive distribution.[19]

According to the Maxima Latvija judgment, the concept of restriction of competition by object is to be interpreted restrictively and can only be applied to an agreement restricting competition if it has a sufficient degree of harm. As the case at hand was not a horizontal agreement (between competitors) but a vertical agreement (between non-competitors), the CJEU did not conclude that the object of that agreement is to restrict competition. In its view, commercial lease agreements can be regarded as agreements which may have the effect of restricting competition, the intensity of which will depend, inter alia, on the position of the parties in the market concerned and the duration of the agreement.

There are several practical aspects of distinguishing agreements according to whether they have the object or effect of restricting competition. One is the burden of proof. The ‘objects’ doctrine is useful for a competition authority, as, if it qualifies an agreement as restrictive ‘by object’, it does not need to undertake any detailed analysis to find evidence of the agreement’s effect on the market. (...) On the contrary, where an agreement is categorized as restrictive ‘by effect’, the acting competition authority bears the burden to prove the negative effects of the agreement on competition.[20]

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[18]Judgment of the Court of Justice (Fourth Chamber) of 26 November 2015. SIA ‘Maxima Latvija’ v. Konkurences padome. Case C-345/14 [online]. Available from: https://curia.europa.eu/juris/document/document.jsf?text=&docid=172145&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=4369394 [30. 9. 2022].

[19]Judgement of the Court of 28 February 1991. Stergios Delimitis v. Henninger Bräu AG. Case C-234/89 [online]. Available from: https://curia.europa.eu/juris/showPdf.jsf?text=&docid=96846&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=4368184 [30. 9. 2022].

[20]TROCH, Simon; SBROLLI, Cecilia: The EU Court of Justice rules on limited exclusivity restriction in lease agreements and concludes that it is not a restriction by object (Maxima Latvija). *e-Competitions – National Competition Laws Bulletin*, 2015 (November), p. 4 [online]. Available from: https://orbi.uliege.be/bitstream/2268/233659/1/2016%20-%20S.%20Troch%20and%20_C.%20Sbrolli%20-%20The%20EU%20Court%20of%20Justice%20rules%20on%20limited%20exclusivity%20restriction%20in%20lease%20agreements%20and%20concludes%20that%20it%20is%20not%20a%20restriction%20by%20object%20.pdf [30. 9. 2022].

According to the CJEU, it is therefore necessary to:

- first, take into account "all of the factors which determine access to the relevant market, for the purposes of assessing whether, in the catchment areas where the shopping centres which are covered by those agreements are located, there are real concrete possibilities for a new competitor to establish itself, including through the occupation of commercial premises in other shopping centres located in those areas or by occupying other commercial premises located outside the shopping centres. Accordingly, it is appropriate in particular to take into consideration the availability and accessibility of commercial land in the catchment areas concerned and the existence of economic, administrative or regulatory barriers to entry of new competitors in those areas",[21]
- second, "the conditions under which competitive forces operate on the relevant market must be assessed. In that connection it is necessary to know not only the number and the size of operators present on the market, but also the degree of concentration of that market and customer fidelity to existing brands and consumer habits".[22]

In connection with the above mentioned O. Stefanowicz presents a three-tiered comprehensive analysis that includes the following factors[23]:

a) market access,
b) competitive forces in the relevant market,
c) the impact of the exclusivity clause on actual or potential market foreclosure.

Although the CJEU has only considered the first type of exclusivity clause, i.e. tenant-required, we consider that the so-called radius clause will be subject to the same regime. Also, it is not concluded between direct competitors, i.e. it operates at a vertical level. Nor is it intended to eliminate competition between two landlords directly; this is merely its side effect.

On the basis of the analysis of the applicable legislation in the EU and in the Slovak Republic as well as the case law of European and national courts, we can thus come to general conclusions regarding the legal nature of exclusive clauses in lease agreements. At the same time, we present the main legal and economic criteria that are of significant influence to this legal nature.

[21]Para. 27 of the Judgment.
[22]Para. 28 of the Judgment.
[23]For more details see STEFANOWICZ, Olga: Guidance on the Limits for the Use of Restrictive Clauses in Commercial Lease Agreements – Once Again on Restrictions "by Object". Case Comment to the Preliminary Ruling of the Court of Justice of 26 November 2015 SIA 'Maxima Latvija' v. Konkurences padome. In.: *Yearbook of Antitrust and Regulatory studies*. 2016, 9 (14), p. 288.

CONCLUSION

The inclusion of an exclusivity clause in a lease agreement is not automatically illegal. However, it may meet the criteria of an agreement which has the effect of restricting competition. In order to assess the permissibility of an exclusivity clause in a lease agreement, it is necessary to examine the circumstances of the relevant market and assess them in the light of the judgment of the Court of Justice of the EU in the case of SIA Maxima Latvija v Konkurences padome of 26 November 2015.

In assessing the admissibility of an exclusivity clause in a lease agreement, the following aspects must be examined:

a) access of competitors to the relevant market, i.e.:
   aa) in the case of an ordinary exclusivity clause, the relevant market is the market for specific goods and services provided to retail customers. Here, it is necessary to examine whether there are economic and legal constraints that would prevent access to the relevant market by entities in a competitive position vis-à-vis anchor tenant, consisting, for example, of such as limited offer of retail premises in the vicinity, their different (lower) standard, lack of transport accessibility or limited parking for customers, franchisors' policy in relation to the territory where the relevant market is located, lack of suitable workforce, stricter hygiene or safety standards, other legal conditions (e.g. if the relevant market crosses national borders),
   ab) in the case of the radius clause, the relevant market is the rental market in relation to owners or operators of commercial premises. Here, it is relevant whether there are economic and legal constraints that would prevent other commercial landlords, including shopping centre operators, from accessing this relevant market, i.e. e.g. lack of suitable infrastructure, planning restrictions, unavailability of financing, lack of suitable space or parking, etc.;
b) the conditions for functioning of the competition in the relevant market, i.e. whether the market is concentrated or deconcentrated; and
   ba) in the case of an ordinary exclusivity clause – what other retail operators are present and what is their size and/or serviceability of the relevant location, what are the habits of customers in the relevant market and whether they are loyal to their retailers and service providers, the level of price competition,
   bb) in the case of the radius clause – what other landlords, owners or shopping centre operators are present, how strong their position is, whether offer of commercial premises prevails over demand or vice versa, what is the price level of rents and what are costs related to

the use of commercial premises (for electricity, heating, water supply, etc.);

c) if conditions a) and b) are fulfilled, the content of the exclusivity clause should be examined to identify its impact on foreclosure of the market. The CJEU notes that two aspects in particular need to be examined: the duration of the contracts concluded and the position of the parties on the relevant market. It is logical that the longer the duration of the clause, the stronger the effect on the restriction of competition and, at the same time:
   ca) in the case of an ordinary exclusivity clause, its effect on the restriction of competition will be the stronger, the more significant the position of the tenant on the relevant market for the retail sale of specific goods and services and
   cb) in the case of a radius clause, the more significant the landlord's position in the relevant market for the rental of commercial premises, the stronger will be its restrictive effect on competition.

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[13] Judgement of the Court of 28 February 1991. Stergios Delimitis v. Henninger Bräu AG. Case C-234/89 [online]. Available from: https://curia.europa.eu/ juris/showPdf.jsf?text=&docid=96846&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=4368184 [30.9.2022].

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[19] Decision of the Supreme Court of the Slovak Republic (Najvyšší súd Slovenskej republiky), Case No. 5Sžh/2/2015 of 2 November 2016 [online]. In *slov-lex.sk*. Ministerstvo spravodlivosti Slovenskej republiky [30. 9. 2022]. Available from: https://www.slov-lex.sk/vseobecne-sudy-sr/-/ecli/ECLI-SK-NSSR-2016-9015898699_2.

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SECTION IV
CONSUMER PROTECTION

Selected aspects of Compensation in the Dieselgate case in Germany

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Abstract: *In September 2015, it was revealed that the German company Volkswagen AG had installed a so-called defeat device in more than 11 million vehicles between 2009 and 2015. The purpose of this device was to detect that the vehicle is being subjected to a laboratory emissions measurement and activate a low-emission mode for such a case. In normal operation, however, the emissions of affected vehicles greatly exceeded the limits set by relevant EU regulation. Courts around the world are still hearing claims for damages from millions of affected owners, mainly on the grounds that they were misled when they bought the vehicle that it met the mandatory emission standards. The aim of the paper is to explore insofar the reasoning developed by the German courts may be applied by other Central European courts, in particular the Czech ones. To this end, the paper will describe and analyse the German legislation and the case law of the Court of Justice of the EU (CJEU) and the German courts and also compare the wording of the corresponding Acts applicable to awarding damages for misleading consumers. The chosen task was addressed by means of reviewing relevant legislation, court decisions and academic texts. The research carried out revealed that, although a substantial part of the problems have already been resolved, some issues are still open and await the final word from the CJEU. The conclusions of the German courts are also applicable to the Czech legal environment. The results of this work provide an understanding of how the German justice has dealt with the claims of injured purchasers, and also to what extent are conclusions of German courts applicable to the Czech legal environment.*

Keywords: *automotive, compensatory damages, consumer rights, deception, defeat device, environment, emissions, fraud.*

INTRODUCTION

The topic of this paper is the 2015 Volkswagen AG (hereinafter "VW") emissions scandal with the so-called "defeat device". The article focuses on damages actions and the types and conditions of the claims of car buyers and the legality of the defeat device. This issue has yet to be fully exhausted as new case law is constantly being developed and some legal issues are still to be resolved. The topic of the paper was chosen because the views of the German Federal Court of Justice (hereinafter "BGH") are not only well reasoned but also to a large extent transferable to similar legal systems, e.g. the Czech or the Austrian ones.

Moreover, the opinions of the Court of Justice of the European Union (hereinafter "CJEU") are binding on all EU Member States.[1] [2] The intent of this paper is to provide the reader with all the information needed to understand the applicability of current view of the BGH and the CJEU on manufacturer liability in the use of an illegal defeat device by Czech courts.

I have drawn mainly on the cited case law of the BGH and CJEU and the work of Professor Dr. Michael Heese, LL.M. from the University of Regensburg in Germany on the Dieselskandal Project: Herstellerhaftung.[3]

1. BRIEF HISTORY

In September 2015, the U.S. Environmental Protection Agency (EPA) released information that the German car manufacturer, VW, had installed software in its vehicles, cheating on emissions measurements under the federal Clean Air Act.[4] [5] It was later revealed that the fraud involved not only VW cars but also other vehicles from the concern (Skoda, Seat and Audi) manufactured between 2009 and 2015 and had been operated worldwide, notably in the EU. In total, the emissions scandal known as "Dieselgate" affected more than 11 million vehicles. The deception lay in that the software controlling the diesel engine (series EA189) had been programmed to detect whether the vehicle was being subjected to emissions measurements on the test bench. During the emissions measurements, the engine automatically switched to "exhaust gas recirculation 1" mode, which reduced nitrogen oxide (NOx) emissions below the mandatory limits, but also reduced power and higher fuel consumption. Conversely, during normal operation, the engine usually switched to the 'exhaust gas recirculation 0' mode, which resulted in excess NOx emissions. Thus, the NOx limit values of the Euro 5 standard were only met during the emission measurements.[6]

Following these findings, the German Federal Motor Transport Authority

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[6] FRIGESSI DI RATTALMA, Marco, ed. The Dieselgate [online]. Cham: Springer International Publishing, 2017 [viewed 22 October 2022]. ISBN 9783319483221. Available from: doi:10.1007/978-3-319-48323-8.

(Kraftfahrt-Bundesamt, KBA) decided on the 15th of October 2015 that the engine of type EA189 indeed had a prohibited "defeat device".[7] The Volkswagen Group should therefore recall approximately 2.4 million vehicles in Germany and remove the defeat device. In a press release dated 25 November 2015, the Group announced that it would update the software of all vehicles with EA189 engines and deactivate the defeat device.[8]

The software update was prepared in 2016 and vehicles with EA189 engines were gradually recalled and updated. In many cases partial hardware modifications were also carried out. Until then, the vehicles were fit for service according to the Kraftfahrt-Bundesamt (KBA) decision. Also, a feature known as the 'temperature window' was added to the software. Due to this feature, the emission control system operates at 100% only when the outside temperature is between 15 and 33 °C and the altitude is below 1,000 meters. If the vehicle is outside the temperature window or at higher altitude, the NOx emission standards may not be met.[9] There could also be an increase in fuel consumption and a decrease in engine performance after the software and/or hardware update.[10]

2. LEGALITY OF DEFEAT DEVICE

Vehicle type-approval (homologation) is harmonised at EU level in Article 5(2) of the Regulation (EC) No 715/2007 of the European Parliament and of the Council of 20 June 2007 on type approval of motor vehicles with respect to emissions from light passenger and commercial vehicles (Euro 5 and Euro 6) (hereinafter "Regulation"). CJEU therefore has the final word in the interpretation of the Regulation. The legal implications of the emissions scandal have previously been and continue to be dealt with by the CJEU in several preliminary ruling procedures under Article 267 of the Treaty on the Functioning of the European Union.[11]

Under the Regulation, car manufacturers must demonstrate that all new vehicles put into service in the EU comply with the emission limits set out in Annex I to the Regulation.

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[7] *Kraftfahrt-Bundesamt – Presse / Öffentlichkeitsarbeit – Kraftfahrt-Bundesamt ordnet den Rückruf von 2,4 Millionen Volkswagen an*. (2015, October 16). Kraftfahrt-Bundesamt – Startseite. https://www.kba.de/DE/Presse/Archiv/Abgasthematik/vw_inhalt.html.

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[10] STJERNA, Mikael Stjerna. (2017, March 29). Dieselgate: Volkswagen cars lose power after fix. Teknikens Värld. https://teknikensvarld.expressen.se/nyheter/bil-och-trafik/dieselgate-volkswagen-cars-loses-power-after-fix-456111/.

[11] Treaty on the Functioning of the European Union [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012E%2FTXT.

In a landmark judgement of 17 December 2020, Case C-693/18[12], the CJEU first confirmed that software which recognizes that an emissions measurement test is in progress and which only reduces emissions for the duration of the test is a prohibited "defeat device" within the meaning of Article 5 of the Regulation. This is notwithstanding the fact that, under certain conditions, the lower emission 'test mode' may be activated even during normal use of the vehicle. The bottom line is that for most of the time the emissions limits are not complied with in normal operation. The CJEU ruled similarly in joined cases C-690/18, C-691/18 and C-692/18 in its judgement of 6 May 2021.[13]

In a recent judgement of 14 July 2022, case C-128/20, the CJEU also addressed, for the first time, the temperature window that was installed as part of the update prepared by VW in response to the emissions scandal.[14] According to the CJEU, the temperature window also constitutes a prohibited defeat device. For owners of cars with this software, this opened a new path to compensation. The CJEU ruled similarly in cases C-134/20[15] and C-145/20[16].

3. COMPENSATION FOR DAMAGES

3.1. Basis of claim

The case-law of the German courts has over time established that VW's deception in emissions measurement and misleading of customers is intentional and immoral within the meaning of Section 826 German Civil Code [Bürgerliches Gesetzbuch, hereinafter "BGB"].[17] For the first time, the German BGH[18] expressed this opinion in the landmark judgement of 25 May 2020, Case VI ZR

[12] Judgment of the Court of Justice of 15 February 2021. Criminal proceedings against X. Case C-693/18 [online]. In EUR-Lex. [accessed on 2022-09-18]. Available from: https://curia.europa.eu/juris/document/document.jsf;jsessionid=8890FB8E906A1BE875B8134798E3744B?text=&docid=237784&pageIndex=0&doclang=CS&mode=req&dir=&occ=first&part=1&cid=1055.

[13] Judgment of the Court of Justice of 6 May 2021. Joined Cases C-690/18 to C-692/18 [online]. In EUR-Lex. [accessed on 2022-09-18]. Available from: https://eur-lex.europa.eu/legal-content/CS/TXT/?uri=CELEX:62018CO0690.

[14] Judgment of the Court of Justice of 14 July 2022. GSMB Invest v Auto Krainer. Case C-128/20 [online]. In EUR-Lex. [accessed on 2022-09-18]. Available from: https://curia.europa.eu/juris/ document/document.jsf?text=&docid=262933&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=2951.

[15] Judgment of the Court of Justice of 14 July 2022. IR v. Volkswagen. Case C-134/20 [online]. In EUR-Lex. [accessed on 2022-09-18]. Available from: https://curia.europa.eu/juris/document/ document.jsf?text=&docid=264844&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=4417.

[16] Judgment of the Court of Justice of 14 July 2022. DS v Porsche and Volkswagen. Case C-145/20 [online]. In EUR-Lex. [accessed on 2022-09-18]. Available from: https://curia.europa.eu/juris/ document/document.jsf?text=&docid=264855&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=4815.

[17] GERMANY Act, the Civil Code [RGBl.I Seite 195, Bürgerliches Gesetzbuch].

[18] In German it is Bundesgerichtshof or abbreviated BGH.

252/19.[19]

The BGH found that VW had systematically, over many years, installed fraudulent software in the EA189 series of engines on the basis of a strategic decision in the development of the engines. The purpose was to save costs and therefore to maximise profit.

The emissions cheating resulted in increased nitrogen oxide pollution, which was harmful to both people and the environment.[20] The Dieselgate case has even been linked to the fact that the reduction of NO_2 emissions in Prague is lower than expected on the basis of mandatory emission limits.[21] There was also a risk that the vehicles concerned could be banned from operating, if authorities were to find out about the defeat device. The huge number of vehicles involved demonstrates the particularly despicable nature of the behaviour of VW. The BGH also found that the former Board of Directors and Head of Development had already become aware of the illegal practice in 2011. Their conduct was attributable to VW on the basis of Section 31 BGB, according to which a company is liable for the damage caused by the board, a member of the board or another constitutionally appointed representative.

Under Czech law, VW's conduct could be assessed under the analogous provision of Section 2909 of the Civil Code[22], which imposes an obligation on the wrongdoer to compensate for damage caused by intentional conduct contrary to good morals. The Czech legislation does not differ in meaning from Section 826 of the German Civil Code.

Anyway, on 22 September 2015, VW issued a press release admitting to irregularities in the software of the EA189 engine control unit and promising to remedy them.[23] According to the BGH, the carmaker changed its behaviour substantially after that date and no longer behaved immorally. Therefore, persons who after that point purchased a vehicle with an EA189 engine are not entitled to compensation pursuant to Section 826 BGB. It is irrelevant whether the buyers knew that the vehicle had an illegal defeat device installed (decisions of the BGH

[19] Decision of the Bundesgerichtshof, Germany of 25 May 2020, No. VI ZR 252/19 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-18]. Available from: https://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=pm&Datum=2020&anz=73&pos=10&nr=106368&linked=urt&Blank=1&file=dokument.pdfdokument.pdf.

[20] JONSON, J. E., et al. Impact of excess NO x emissions from diesel cars on air quality, public health and eutrophication in Europe. Environmental Research Letters [online]. 2017, 12(9), 094017 [viewed 22 October 2022]. ISSN 1748-9326. Available from: doi:10.1088/1748-9326/aa8850.

[21] VOJTISEK-LOM, Michal, et al. High NO2 Concentrations Measured by Passive Samplers in Czech Cities: Unresolved Aftermath of Dieselgate? Atmosphere [online]. 2021, 12(5), 649 [viewed 22 October 2022]. ISSN 2073-4433. Available from: doi:10.3390/atmos12050649.

[22] CZECH REPUBLIC Act No. 89/2012 Coll., the Civil Code [zákon č. 89/2012 Sb., občanský zákoník].

[23] Ad hoc: VW has issued the following information. Volkswagen Group Homepage [online]. 22 September 2015 [viewed 18 September 2022]. Available from: https://www.volkswagenag.com/en/news/2015/9/Ad_hoc_US.html.

in cases No. VI ZR 5/20[24] and No. VI ZR 244/20[25]).

Although the CJEU concluded that the temperature window is an illegal defeat device (see the above-mentioned case C-128/20 and related cases), the BGH, on the other hand, does not consider the installation of the temperature window to be intentional or immoral conduct, so that vehicle owners are not entitled to compensation against the manufacturer in this respect pursuant to Section 826 BGB (decision of the BGH of 9 February 2021, Case No. VI ZR 397/19[26]).

In my opinion the installation of the temperature window definitely should be regarded at least as a negligent act giving rise to a claim for damages under section 623 BGB. VW should and could have known that software which ensures compliance with the emission limits in normal operation for only part of the year does not comply with the requirements of the Regulation. In this respect, I disagree with the conclusions of the BGH and I expect that future decisions will reflect the recent decisions of the CJEU (i. e. case C-128/20) so even buyers of vehicles with illegal temperature windows will be compensated.

3.2. Claims of vehicle owners

As the BGH has established in its judgement in case No. VI ZR 252/19, the damage itself consists in the acquisition of a vehicle equipped with a prohibited defeat device. At the time of the purchase, the buyer was unaware that the vehicle had such a defeat device. It cannot be excluded that the buyer would not have purchased the vehicle in such circumstances or purchased the vehicle at a lower price. The amount of damages is determined in accordance with Section 249 BGB, according to which the liable person must restore the position that would have existed if the circumstance obliging them to pay damages had not occurred. The same rule is contained in Section 2951 of the Czech Civil Code, so the BGH's conclusions in this case can be easily adopted in the Czech legal environment. The manufacturer of the vehicle is in this case the person liable to pay compensation being the agent who behaved immorally.

As the BGH held in its judgement of 6 July 2021, No. VI ZR 40/20, the

[24] Decision of the Federal Court of Justice, Germany of 30 July 2020, No. VI ZR 5/20 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-18]. Available from: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&az=VI%20ZR%205/20&nr=109083.

[25] Decision of the Federal Court of Justice, Germany of 8 December 2020, No. VI ZR 244/20 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-18]. Available from: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&nr=113265.

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vehicle owner can choose between two forms of compensation.[27] The owner may choose to keep the vehicle and claim compensation for the amount overpaid at the time of purchase (so-called small damages or kleiner Schadensersatz). According to the BGH, a vehicle that has fraudulently obtained EURO 5 type approval is undoubtedly worth less than a vehicle that has obtained such approval properly.

Alternatively, the buyer can claim a refund of the purchase price against handover of the vehicle (so-called large compensation, or großer Schadensersatz). However, the compensation must be reduced by the buyer's utility calculated on the basis of the mileage driven. The compensation for the use of the vehicle may even consume the entire compensation claim. Interest on the purchase price can also be claimed from the expiry of the time limit set by the buyer for a refund of the purchase price against the return of the vehicle. The same conclusion could be reached under Section 2951 of the Czech Civil Code. The buyers have the right to choose whether they want "restitutio in integrum" compensation (i.e. return of the purchase price against return of the vehicle), or whether they want only monetary compensation for overpayment and keeping the vehicle.

The buyer has the right to these claims even if a software update removing the defeat device has been installed. Improvement or deterioration of the vehicle's characteristics caused by the update must be taken into account in the calculation too. BGH expressed a similar opinion in its decision of 5 October 2021, No. VI ZR 136/20.[28]

The calculation procedure was shown in the case No. VI ZR 252/19 where BGH firstly estimated the expected total mileage of the vehicle before it was parked (300 000 km). The gross purchase price paid by the applicant (31.490,00 EUR) was then multiplied by the mileage (52,229 km) and the resulting value was divided by the expected remaining mileage at the time of purchase (280,000 km). The calculation of the benefit from use is always determined by the court after taking into account all the circumstances in its discretion, which is implied by Section 287 of the German Code of Civil Procedure [Zivilprozessordnung].[29] In the case in question, the benefit of use was calculated at 5.873,90 EUR, so that the purchaser received 25.616,10 EUR after offsetting the purchase price against the return of the vehicle to the manufacturer. It is impossible to predict whether Czech courts would calculate compensation in the same

[27] Decision of the Federal Court of Justice, Germany of 6 July 2021, No. VI ZR 40/20 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-18]. Available from: https://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&nr=121426&pos=0&anz=1.

[28] Decision of the Federal Court of Justice, Germany of 5 October 2021, No. VI ZR 136/20 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-18]. Available from: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&az=VI%20ZR%20136/20&nr=123496.

[29] GERMANY, Code of Civil Procedure [Zivilprozessordnung], hereinafter „ZPO".

way, but German case law and legal theory is usually an important source of inspiration for Czech judges.[30]

3.3. Resale or destruction of the vehicle

While the case-law of the lower courts has reached various conclusions, the BGH has confirmed in two decisions of 20 July 2021 (Case No. VI ZR 533/20 and No. VI ZR 575/20) that the resale of a vehicle does not extinguish the right to compensation for damage.[31] [32] The original buyer is still entitled to a refund of the purchase price, but the purchase price received by the original buyer from the new buyer must be included. This means that if a buyer bought a used vehicle for 20,000 EUR and then sold it after five years for €5,000, he or she is – after taking into account the 10,000 EUR benefit from the use of the vehicle – entitled to compensation of 5,000 EUR against the manufacturer. The new owner of the vehicle has no further claim against the manufacturer. The same conclusions could also be reached under Section 2952 of the Czech Civil Code, according to which lost profits are also covered as part of damages.

The buyer's claim remains unaffected even if the vehicle is destroyed. This risk of destruction is borne by the manufacturer with malicious intent, but any contributory liability under Section 254 BGB must be taken into account. Any insurance claims received must also be offset. I find this conclusion reasonable and fair because the fact that the vehicle was destroyed does not change the fact that the damage was caused (overpayment of the vehicle at the time of purchase). The Czech courts would probably view the situation in the same way.

3.4. Limitations of claims for damages

The claims of the buyers against the car manufacturer are time-barred within the general period of 3 years pursuant to Section 195 BGB. The start of the period depends on when the buyer acquired positive knowledge that an illegal defeat device had been installed in the vehicle. In only a very few cases has VW been able to prove that the buyer already knew about the defeat device in 2015. In such a case, the limitation period would have started to run at the end of 2015

[30] Decision of the Ústavní soud, Czech Republic of 8 July 2010, No. Pl. ÚS 3/09 [online]. In NALUS Database. Constitutional Court. [accessed on 2022-10-22]. Available from: https://nalus.usoud.cz/Search/GetText.aspx?sz=pl-3-09.

[31] Decision of the Federal Court of Justice, Germany of 20 July 2021, No. VI ZR 533/20 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-18]. Available from: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/ document.py?Gericht=bgh&Art=en&nr=121894&pos=0&anz=1.

[32] Decision of the Federal Court of Justice, Germany of 20 July 2021, No. VI ZR 575/20 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-18]. Available from: https://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&sid=e97d6923969a00fdc9f450cfc8190366&nr=121897&pos=0&anz=1.

under Section 199 BGB and expired on the last day of 2018. The car manufacturer was successful in this respect, for example, in the decision of the BGH of 17 December 2020, case No. VI ZR 739/20.[33]

In other cases, the BGH has held that anyone could have learned by the end of 2016 at the latest whether their vehicle was affected by the Dieselgate case and that with the help of publicly accessible information sources such as VW's online platform, this was simple.[34] Therefore, in the proceedings in Case No. VII ZR 679/21[35] and No. VII ZR 692/21[36] BGH held that buyers who had acquired general knowledge of the Dieselgate scandal in 2015 and who were not aware of the impact of the scandal on their vehicles until the end of 2016, acted in grossly negligent ignorance within the meaning of Section 199(1) BGB. The statute of limitations therefore began to run not later than the end of 2016 and expired at the end of 2019.

In Czech law, the claim for compensation is time-barred three years after the date on which the injured party became aware of the injury and discovered who was responsible for it (Section 629 of the Czech Civil Code). At the latest, the claim is time-barred 10 years after the damage occurred [Section 636(1)]. Moreover, in this case the damage was first time caused intentionally, so that the claim for damages is ultimately time-barred after 15 years [Section 636(2)].

4. CONCLUSION

The defeat device in the EA189 engine control unit was illegal both at the time of the Dieselgate scandal in 2015 and also after the update that introduced the so-called "temperature window". The manufacturer must ensure that the emission limits are met for the majority of the time in normal operation, not just during emissions measurements or only for a part of the year. The sale of

[33] Decision of the Federal Court of Justice, Germany of 17 December 2020, No. VI ZR 739/20 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-19]. Available from: https://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&az=VI%20ZR%20739/20&nr=113688.

[34] Information on EA189 diesel engines. *Startseite | Volkswagen Deutschland* [online]. [no date] [viewed 19 September 2022]. Available from: https://www.volkswagen.de/de/besitzer-und-nutzer/wichtige-kundeninformationen/aktuelles-zur-diesel-thematik/information-on-ea189-diesel-engines.html.

[35] Decision of the Federal Court of Justice, Germany of 10 February 2022, No. VII ZR 679/21 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-19]. Available from: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&sid=3f1b39226f36d032d2a806aa5795e22f&nr=127570&pos=0&anz=1.

[36] Decision of the Federal Court of Justice, Germany of 10 February 2022, No. VII ZR 692/21 [online]. In *Juris Database* on the Bundesgerichtshof Homepage. Bundesgerichtshof. [accessed on 2022-09-19]. Available from: https://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&sid=81cffcab00cfbf54abe1e0c491f8e508&Sort=3&Seite=8&nr=127573&pos=260&anz=70001.

vehicles with illegal defeat devices is an immoral act and therefore buyers are entitled to compensation. They have the choice of either returning the vehicle and claiming back the purchase price (after deduction of utility) or to keep the vehicle and claim a discount on the purchase price. The buyer has these rights even having sold or destroyed the vehicle. The claim for compensation is time-barred to the end of 2019 at the latest. However, the claims do not arise for a buyer purchasing the vehicle after VW had admitted to irregularities in the EA189 engine software.

By comparing the corresponding Acts, it was found that the conclusions of the German courts are also fully applicable to the Czech legal environment. The German legal system is very close to the Czech one and is considered, together with the Austrian legal system, to be the greatest source of inspiration for Czech legislators and legal practice.[37] Thus, the basis of the claim, the types of claims and the amount of compensation would probably be assessed by the Czech courts in a very similar way, if not identical. However, I cannot agree with BGH's conclusion that the installation of the temperature window, which was also found by the CJEU to be an illegal defeat device, does not give rise to a claim for damages. At the very least, the purchasers should be entitled to damages for negligent conduct under section 623 BGB.

This post provides information on this ever-topical subject, but some conclusions may be overcome in the near future. If the CJEU rules in favour of the injured parties even in one of the many pending Dieselgate cases, a new wave of actions can be expected. This, together with the pending actions before the BGH, means that further research in this direction will be necessary in the future.

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Court practice in disputes over customary rent in a situation of dominant or more favourable economic position of the landlord[1]

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Abstract: *This paper examines how the determination of the local customary rent has historically been carried out through court decisions in areas where the landlord has a dominant or economically more advantageous position, especially in terms of the criteria for determining the amount of customary rent and the practice of the courts in taking into account the position of landlords (dominant position under the Act on Protection of Competition or more favourable economic position), its possible abuse in determining the amount of customary rent and the reflection of the phenomena of competition resulting from the position of the dominant company, such as e.g. „price leading". The issue of rent increases by the court is examined in the cases of former corporate apartments privatised to investors in the rental business, where, if no rent increase was agreed by the parties, only the court was entitled to determine the rent pursuant to Section 2249(3) of the Czech Civil Code. The authors argue that the legislative regulation of customary rent and subsequent case law have led to an erosion of fundamental constitutional and legal guarantees, as well as to economic inefficiencies.*

Keywords: *competition, customary rent, price leadership.*

INTRODUCTION AND METHODOLOGY

The amount of rent under the lease is usually negotiated by agreement

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between the parties. However, if the rent is not agreed upon, the landlord is entitled to the rent in the amount that is customary for a new lease of a similar apartment under similar contractual conditions on the date of concluding the contract, pursuant to Section 2246(2) of Act No. 89/2012 Coll., the Czech Civil Code (hereinafter referred to as the "CC" or the "Civil Code"). If no rent increase is agreed and the tenant does not agree with the proposal to increase the rent, only the court may determine the customary rent by decision pursuant to Article 2249(3) of the Civil Code.

The issue of rent increases by the court is particularly relevant in the case of former state enterprises´ flats[2], which were privatised to investors in the rental business.[3] The concept of customary rent is itself vague and the amount of rent must be determined by the court in each specific case - certain guidance in this respect is provided by Government Regulation No. 453/2013 Coll. Nevertheless, questions arise as to what this determination looks like in practice and what the criteria accepted by the courts are (e.g. in the case of expert opinions). What was the judicial approach to customary rent before the new Civil Code or Regulation No. 453/2013 came into force?[4]

Finding the level of the customary rent is unlikely to be a major problem in a diffuse rental market in a particular municipality where there is an abundance of rental transactions and a multiplicity of landlords. However, the question of determining the customary rent becomes urgent in markets where the landlord has a dominant position or a more advantageous economic position. What should be the criteria for determining the level of customary rent in this area? Do the courts take into account the position (whether a dominant position under the Competition Act[5] or a more favourable economic position under the Prices Act[6]) of landlords and its possible abuse in determining the level of the customary rent? How, if at all, do they cope with competition phenomena that result from the

[2] These flats were owned by state enterprises and were part of privatization projects.

[3] The larger state-owned enterprises were major employers in the municipalities under socialism and also often the largest investors in corporate housing construction. For this reason, they were often able to dominate the housing market in these municipalities after the transition to the market economy. In the examined context, these were e.g. the state-owned enterprises Třinecké železárny, OKD, Uranové doly Hamr, etc.

[4] In connection with former company flats, it is worth mentioning, for example, that Decree No. 453/2013 Coll., in the provisions of Section 4(3)(a), explicitly states that the rent from flats that are rented as service flats is not taken into account when determining comparability. In locations where a single landlord is dominant, it may often be impossible to obtain a sufficiently relevant sample that sufficiently reflects market realities for the purpose of setting rents in former company flats.

[5] See Section 10 et seq. of Act No. 143/2001 Coll. on the Protection of Competition and on Amendments to Certain Acts. The companies' position was assessed both in the light of Section 10(2) and Section 10(3) of the Act.

[6] See Section 2(3) to (5) of Act No 526/1990 Coll., on prices: CZECH REPUBLIC, Act No. 526/1990 Coll., Act on prices [Zákon č. 526/1990 Sb. Zákon o cenách].

position of a dominant undertaking, such as so-called "*price leading*"[7] ?

The aim of the research is to answer some of the above questions and to find out how the determination of the local customary rent has historically been carried out through court decisions in areas where the landlord has a dominant or economically more advantageous position. These areas or markets were identified mainly on the basis of open-source information, in particular corporate documents of individual landlords[8] , or information from the media or from the Czech Statistical Office. The municipalities concerned with landlords having dominant or economically more advantageous position were Třinec, Karviná, Havířov (DC Karviná), Česká Lípa, Litvínov (DC Most) and Ústí nad Labem.[9]

1. LEGAL BASIS FOR RENT DETERMINATION AND ITS DEVELOPMENT

The amount of rent is usually determined by agreement between the landlord and the tenant. However, if the parties do not agree on the amount of the rent, then according to Section 2246(2) of the CC "the landlord shall be entitled to a rent in the amount which is customary at the date of conclusion of the contract for a new lease of a similar apartment under similar contractual conditions."

If the parties have not agreed on a rent increase and the tenant does not agree with the landlord's proposal, then the method of increasing the rent according to Section 2249(3) of the CC applies, i.e. the landlord "shall have the right to propose within a three months that the amount of rent be determined by the court"; (...) "The court, upon the landlord's proposal, shall decide on the rent up to the amount that is customary in the place and time with effect from the date of the court's proposal". In order to implement the specific method of determining the comparable rent pursuant to Article 2249(2) of the CC, Government Decree

[7] According to the definition of the OECD (Glossary of Industrial Organisation Economics and Competition Law, compiled by R. S. Khemani and D. M. Shapiro, commissioned by the Directorate for Financial, Fiscal and Enterprise Affairs, OECD, 1993.), "price leadership" refers to a situation where prices and price changes established by a dominant firm, or a firm are accepted by others as the leader, and which other firms in the industry adopt and follow. On the phenomenon of price leadership in microeconomic theory, e.g. DENECKERE R. J., KOVENOCK D., Price Leadership. The Review of Economic Studies, Volume 59, Number 1, January 1992, pp. 143-162, https://doi.org/10.2307/2297930, or SEATON S., WATERSON M. Identifying and characterising price leadership in British supermarkets, International Journal of Industrial Organization, Volume 31, Issue 5, 2013, pp. 392-403, https://doi.org/10.1016/j.ijindorg.2013.07.002.

[8] These were, for example, prospectuses for issues of securities of the lessors themselves or persons controlling the lessors - e.g. Basic Prospectus of the Bond Programme of CPI BYTY, a.s. (cit. 2022-09-22, available from (www): https://www.rb.cz/attachments/korporatni-dluhopisy/zakladni-prospekt-dluhopisoveho-programu-cpi-byty.pdf) or the prospectus for the initial public offering (IPO) of Domus as the person exercising influence in Heimstaden Czech s.r.o. (formerly RESIDOMO, s.r.o.) - Domus N.V. Prospectus], available from (www): https://www.afm.nl/en/professionals/registers/meldingenregisters/goedgekeurde-prospectussen/details?id=2530).

[9] The research looks at judgments from 2010 onwards. In 2010, controlled rent deregulation came to an end with some exceptions.

No. 453/2013 Coll., on determining the details and procedure for determining the comparable rent customary in a given place (hereinafter referred to as the "Decree") was adopted in 2013, according to which the customary rent is determined by comparing 3 comparable rents or by an expert opinion (Article 3 of the Decree).

The current legislation on the judicial determination of rents constitutes the result of many years of development, which largely concerned regulated rents. Given the focus of this article, we will deal with aspects of rent regulation only marginally, as this topic has been dealt with in other publications.[10] After the end of controlled rent deregulation, the need arose to establish legal rules for determining rents in cases where they were not determined by agreement between the parties. As an outcome of the legislative process, Act No. 132/2011 Coll. was adopted, which resulted in a substantial modification of the provisions of Section 696 of the now repealed Act No. 40/1964 Coll., the Civil Code, which regulated the determination of rent in cases where no agreement of the parties was reached. The legislation was then adopted in a similar form in the current Civil Code (Section 2249 of the Civil Code).[11] The legislation adopted was unique in the Czech legal system. From a comparative[12] point of view, the legislation was clearly an imperfect implant of the German legislation[13] - even as in Germany, it was originally assumed by the government that public institutions would create price maps of rents in order to make the customary rent in a given place easily determinable for the parties to the lease. Despite an attempt by the Ministry of Regional Development, a relevant, long-maintained comprehensive rent map did not eventually emerge.[14] The emergence of a relevant rent map was probably hampered by the desire to save money on its production - a single expert was used by

[10] E.g. POHL M. Current legal issues related to rental housing [in Czech], Jurisprudence 2/2011, HERC T. Judicial protection of landlords in matters of rent regulation. Právní rozhledy [in Czech], 17/2009, pp. 601-611. On deregulation, see also KULOGLIJA PODIVÍNOVÁ M. From the rent agreement to its judicial and statutory regulation [in Czech], Právní rozhledy, 13-14/2012, pp. 494-499.

[11] Due to the insignificant differences in legislation, the research did not distinguish between judgments that applied the former legislation and judgments that applied the current one.

[12] For more details, see e.g. DOHNAL J., STEHLÍK O. On the increase of residential rents in the new Civil Code. Právní rozhledy, 5/2014, pp. 177-180.

[13] See Article 557 et seq. Buergerliches Gesetzbuch (BGB), in particular Article 558 BGB.

[14] For example, in the judgment of the Ostrava Court of Justice No. 85 C 273/2019-110 of 22 December 2020, which was not included in the analysed sample, the court complementarily argued the analysis of market rents prepared by Deloitte for the purposes of social policy. This analysis, although it contains map annexes, is not a map of normal rents. However, the rents established on the basis of that analysis do not correspond to the concept of normal rents in the light of the methodology used and should therefore not be used.

IRI, spol. s r.o., which produced the map for the Ministry of Regional Development[15]. The legislation did not adopt from the German legislation either the criteria for determining the locally customary rent or the significant role of municipalities or interest associations of tenants and landlords.

The concept of former and, to a large extent, also the current legislation of the rental increase is very problematic and contains elements that are contrary to the basic principles of private law, without being justified by the special nature of the legislation.

1.1. Problematic aspects of the legislation

The first problematic element of the regulation is the fixed moment at which the rent is determined, i.e. the date of filing the action. The determination of rent is a constitutive judicial act, where the effects of the judicial decision take effect on the date of its legal force. The granting of retroactive effects (from the filing of the action) by a constitutive judicial decision is very rare, the only other case being the retroactive award of maintenance under Article 922(1) of the Czech Civil Code, which, unlike the rent, has a maintenance and protective function and is systematically classified in the field of family law and not in the field of contract law. The court's decision has, in principle, retroactive effect, without there being any reasons for that arising from the nature or gravity of the issue. The point is that the party (usually the tenant) is not able to adapt their conduct to the new obligation arising from the constitutive court decision, despite the fact that the new obligation may be economically unbearable for them. Such a solution is of course fundamentally unacceptable from the point of view of the rule of law, which is enshrined in Article 1 of the Czech Constitution.[16]

Another problematic aspect relates to the information asymmetry in which the tenants find themselves, as they have no information about the rent. As the weaker party to the contract, the tenant is in a difficult position where they do not have sufficient information about the customary rent to be paid, *not least* in the environment of a dominant landlord. Moreover, even if the tenant has information on the rent, such information may be distorted by the position of the landlord, which is not exposed to substantial price competition and other competitors doing business in the same region adapt to it as price leader. The second aspect of the information asymmetry relates to the above-mentioned construction of the judicial determination of the customary rent from the date of filing of the action.

[15] SKALOVÁ O. The much sought-after price map of rents is stuck. The entire map will not be ready until the end of the year, but the first deregulation of rents has been underway since January [in Czech]. Byznys.cz [online], 2011, [viewed 22 September 2022]. Available from: https://byznys.hn.cz/c1-50873570-mapa-najmu-vazne-na-jedinem-muzi.

[16] On the inadmissibility of retroactivity see e.g. KNAPP, V. Teorie práva. Prague: C. H. Beck, 1995, p. 207 et seq.

In practice, the tenant only learns the amount of their customary rent and the cumulative amount due from the judgment, i.e. long after the action has been brought. Thus, they do not have the opportunity to make the economic choice that they would naturally make under normal circumstances - if the rent in the apartment is too high, they would not rent the apartment or would leave it. The tenant can of course terminate the lease, but not retroactively. The rent map should have been used to eliminate the information asymmetry, but as the research showed, it was not compiled on a sufficient methodological basis and did not take into account, for example, the dominance of the landlord or the landlord's more advantageous economic position. On the contrary, research showed that the map's compiler and the expert who participated in its preparation often acted as the landlord's expert in disputes over rent increases[17]. The expert reports and methodology of these preparers have often been criticized in judgments in specific cases by reviewing experts whose reports have been accepted by the courts.[18] Thus, the rent map may have had the opposite of the intended effect on tenants' information.

A separate problem of the legislation was the whole concept of the process for determining the customary rent in a given place. The current legislation was based on German law, which allows the parties to establish the locally customary rent relatively quickly and at minimal cost. The Czech legislation, despite the attempt to develop a rent map as described above, did not provide this possibility, and a simplified methodology to determine the local customary rent was only included in Government Decree No 453/2013 Coll. of 2014. The reason for the absence of relevant tools to orient tenants was probably the need for savings[19]. Although it does not follow from any legal regulation that the courts cannot independently assess the amount of locally customary rent, the question of customary prices is generally considered by the courts to be an expert one, and therefore expert opinions are generally relied upon in practice. This can then lead to the

[17] An analysis of judgments on the determination of the amount of the customary rent in proceedings before the District Court in Frýdek - Místek serves as a clear example. Out of 43 judgments analysed in the given period, we were able to clearly identify 26 cases where expert opinions for the plaintiff CPI BYTY, a.s. were drafted by Z. V, who participated in developing the rent maps.

[18] See e.g. the judgment of the District Court in Frýdek - Místek No.8 C 195/2011-81 of 22 August 2013: 'The Expert Institute examined the expert opinion of Z. V. and concluded that the IRI methodology is a complicated and opaque method, with hardly traceable information and a very complicated procedure for calculating the cost component of rent, etc. The result is entirely dependent on the input price of the rent according to the IRI database, which, in the opinion of the expert institute, is overestimated without the expert carrying out an investigation into the actual rents negotiated at a given time and place. For this reason, it considers that the rental value stated in this opinion is overestimated. Similarly, e.g. 8 C 79/2012 - 168, 8 C 127/2011 - 99, 8 C 177/2011 - 104, etc.

[19] SKALOVÁ O. The much sought-after price map of rents is stuck. The entire map will not be ready until the end of the year, but the first deregulation of rents has been underway since January [in Czech]. Byznys.cz [online], 2011, [viewed 22 September 2022]. Available from: https://byznys.hn.cz/c1-50873570-mapa-najmu-vazne-na-jedinem-muzi.

proceedings becoming, at best, a 'battle of experts', where the court's hand in selecting the expert drafting the expert report and, to a certain extent, the judge's value orientation in evaluating the reports ultimately determines the rent. In the worst case, the court accepts the landlord's expert opinion (which has usually already prepared it with regard to the call for a rent increase pursuant to Section 696(2) of Act No. 40/1964 Coll., Civil Code or Section 2249(1) of the Civil Code), since the tenant does not propose the drafting of an expert opinion for financial reasons.

Several problematic elements of the analyzed legislation have been described above - significant information asymmetry, incorrect determination of the period from which rent is determined, lack of methodology and dependence on expert opinions, lack of protection of the weaker party and creation of room for abusing dominant position, lack of consideration of the overlap of procedural rules into social rights of tenants.

The aim of the research was to find out how the courts proceeded in the selected areas and whether the above-described negative aspects of the legislation were reflected in their decisions.

2. RESULTS OF QUANTITATIVE RESEARCH

In the quantitative part of the research, 104 judgments of six courts were analysed. The data of 94 judgments were included in the analysis, 10 judgments were excluded from the quantitative analysis due to incompleteness and therefore incomparability of data.

2.1. Increase claimed and awarded

On average, the plaintiff sought an increase of 120% over the baseline rent level. The claim was significantly lower in the cases examined by the Regional Court in Ostrava (78%), while in the cases examined by the District Court in Most the claimant claimed the highest increase in the level of rent (by 148% against the baseline level).[20].

In the decisions, the courts awarded the plaintiff an average increase of 75% over the baseline rent level. Relatively, the highest number of decisions was found in the decisions of the District Court in Most (by 123% against the default rent level), while the lowest number was found in the decisions of the District Court in Česká Lípa (by 39%).

In the cases where the courts proceeded to prepare a review report, the average relative rent increase awarded was lower (by 67%), while at the same time the plaintiff in these cases requested on average a higher rent increase than in the other cases (by 127%).

[20] However, due to the relatively low frequency of cases examined (6) in the case of the District Court in Most, this may be a statistically insignificant sample.

Table 1 Comparison of average rent increases requested and granted

Court	Average increase requested (%)	Average increase achieved (%)
District Court Most	148 %	123 %
District Court Ústí nad Labem	140 %	122 %
District Court Frýdek Místek	132 %	74 %
Regional Court Ostrava	78 %	66 %
District Court Karviná	89 %	61 %
District Court Česká Lípa	100 %	39 %
Total	120 %	75 %

Table 2 Comparison of the average requested and awarded rent increase in the case of a revised expert report

Court	Average increase requested (%)	Average increase achieved (%)
District Court Most	180 %	174 %
District Court Frýdek Místek	142 %	68 %
Regional Court Ostrava	89 %	51 %
District Court Karviná	51 %	27 %
Total sum	127 %	67 %

2.2. Relative success rate of the claimant

The claimant's success rate in terms of the extent to which they were able to achieve the requested increase in rent averaged 74 %, so the claimants did not achieve the full increase in rent levels requested on average, but their claim was nevertheless largely satisfied. Mostly in cases decided by the District Court in Ústí nad Labem (90 %), least in cases decided by the District Court in Česká Lípa (40 %).

Table 3 Plaintiff's relative success rate

Court	Plaintiff's success rate on the amount of rent awarded (%)
District Court Most	81 %
District Court Ústí nad Labem	90 %
District Court Frýdek Místek	81 %

Regional Court Ostrava	54 %
DC Karviná	68 %
DC Česká Lípa	40 %
Total	74 %

2.3. Costs of proceedings

The average court costs amounted to less than 22 thousand CZK, approximately four times the level of the monthly rent awarded by the court.

CONCLUSIONS

Several conclusions emerged from the research. There were relatively few legal disputes given the number of tenancy relationships. In terms of the number of rental flats owned by the dominant rental housing providers that were the subject of the research, there were relatively few disputes over the determination of ownership, with most disputes recorded in the city of Trinec[21]. According to the authors, there may be several reasons for the overall low number of disputes. Firstly, there is the aforementioned information asymmetry, where tenants drew information on the customary rent mainly from the landlord (with regard to their obligation under Section 696 of Act No. 40/1964 Coll., Civil Code, or Section 2249 of the Civil Code) and thus could not have information on the amount of the customary rent.

Another undoubted fact was the threat of litigation itself, which may have been substantial for many tenants who never litigated. The costs of litigation, which are relatively high in terms of the value of the dispute, may also have played a role in this context. In the case of several expert reports and a review report, the costs of the court proceedings amounted to tens of thousands of crowns[22] , and in some cases the research noted excesses where the amount of compensation was calculated not on the difference between the determined rent and the original rent, but on the determined rent as such. Thus, the amounts of

[21] One of the companies concerned, CPI Byty a.s., owned nearly 4,000 rental flats of total 5553 rental flats in Třinec, in the judicial district of Frýdek-Místek the company has had less than 150 disputes. Another company, RPG Byty s.r.o., owned approximately 12,000 rental flats in Havířov of 20 257 total rental flats, 7,500 rental flats in Karviná of 10 881 total rental flats, 2000 (3 642) in Orlová, etc. (i.e. in the judicial district of the Karviná District Court). In this district RPG Byty s.r.o. has had less than 20 disputes. Considering the total number of landlord-tenant relationships (in spite of the fact that not all of the landlord-tenant relations were affected by unilateral rent increases), the number of disputes appears to be relatively small. The data were collected from the Czech Statistical Office.

[22] The average cost of litigation in the district courts was 2.79 times the monthly rent. The most statistically significant sample is the District Court in Frýdek - Místek, where the ratio of court costs to monthly rent was 3.02 on average.

compensation for costs in these cases reached absurd levels - in the case of determining the monthly rent of CZK 3,213[23] the court set the amount of compensation for the costs of the court proceedings at CZK 103,593, or in another case of determining the rent of CZK 3,485[24] the costs were set at CZK 94,000. It is questionable whether such procedural barriers in consumer disputes, where one party is significantly weaker than the other, are consistent with the constitutionally guaranteed right to a fair trial.

The majority of tenants accepted the proposed rent, despite its possible excessiveness. The fact that there were few disputes over the rent level, given the number of tenancy relationships in the period under review, implies that the vast majority of tenants accepted the conditions for rent increases. However, this also means that they accepted the rent proposed by the landlord (by the experts selected by the landlord), which, as the research showed, was usually tens of percent higher than the customary rent set by the experts appointed by the court. On the other hand, given the high costs of the court proceedings, even tenants who decided not to accept the offer faced the risk of bearing, even partially, the costs of the court proceedings, the average amount of which was CZK 20 458 in the period under review. These costs, in view of the drafted expert reports, usually amounted to tens of thousands of euros and could thus exceed the benefit of lower rents in the medium term. On the contrary, as already mentioned, the costs of legal proceedings are a tax-deductible expense for the landlord-entrepreneur within the meaning of Article 24(2)(p) of Act No 586/1992 Coll., on income taxes, and therefore a landlord who rents apartments as part of their business is objectively in a better position than a tenant from a tax perspective.

The risk that the applicable legislation described above would trigger an abuse of the economic and legal position of landlords demanding higher rents than the objective locally customary rent has materialized. As the research shows, the rents set by the courts have generally been lower than the rents demanded by the landlord and claimed by 'their' experts. Of the 94 cases examined, the courts awarded rent increases of 75% of the original rent.[25] However, the average increase requested by the landlord was 120 %. The rent increases requested by landlords therefore exceeded the actual rent awarded by 60 %. This relative discrepancy between the amount of rent requested and the rent actually awarded is statistically not insignificant. Assuming that the tenants accepted the proposal to increase the rent and that there was no dispute over the determination of the rent, the tenants were paying a rent which was quite excessive in relation to the cus-

[23] Judgment of the District Court in Frýdek - Místek No.14 C 304/2013 - 150 of 19 June 2015.
[24] Judgment of the District Court in Frýdek - Místek No.14 C 18/2014 - 164 of 17 June 2015.
[25] As a rule, the full extent of the claim was upheld in cases where there was an adjudication, as the tenants did not resist for various reasons and the court did not process a review report. This means that the difference between the amount awarded and the amount claimed would be even greater if we did not take these cases into account.

tomary rent. It is therefore appropriate to consider whether these facts are consistent with the prohibition of abuse of a dominant position under the Act on the Protection of Competition, or with the prohibition of abuse of an advantageous economic position under the Act on Prices. Although from a private law point of view it may appear that the rent has been agreed in accordance with the law, from a public law point of view the rent so agreed is unlawful, as it may violate the obligation not to abuse a dominant position or a more favourable economic position (two different facts aimed at protecting different social interests). The rent arrangement could thus be in breach of Section 39 of Act No 40/1964 Coll., Civil Code, or Section 580 CC, or in breach of the general unfair competition clause under Section 2976(1) CC. In the case of the fulfilment of the facts of unfair competition, the case-law of the Supreme Court is quite relevant, according to which, when assessing whether the conduct in question caused harm to consumers, it is necessary to take the viewpoint of the average consumer who has sufficient information.[26] However, the purpose of a legal rule clearly intended to protect consumers fails in that respect, because of the apparent asymmetry of information between the landlord and consumers.

The absence of a methodology for determining the customary rent has led to incorrect procedures for determining the rent and legal uncertainty. A study of the case law of the courts concerned has further confirmed the risks associated with the lack of a methodology for determining the customary rent. Due to the absence of methodology and other correctives, differences in expert opinions were in the order of tens of percent. The final amount was often decided by the revision, i.e. the last, expert report and the judge's hand in selecting the expert who drafted it. Although the court decisions analysed do not always provide us with a completely accurate picture of the experts' procedure for determining rents, it can be stated that, when determining the customary rent, the courts and experts generally did not take into account the rents in municipal flats or, on the contrary, included the rents in flats owned by the dominant landlord. In several cases, on the contrary, the rent has been absurdly increased by the court also for repairs and reconstructions carried out by the tenant themselves[27]. With one exception[28], the experts, and consequently the courts, did not take into account the phenomena of competition law such as price leadership or excessive prices and did not include them in their considerations at all. As it follows from later judgments of the Su-

[26] Supreme Court Judgment No. 23 Cdo 3845/2012-I of 24 April 2013.

[27] Judgment of the Regional Court in Ostrava No. 11 Co 575/2014 - 333 of 24 March 2015, judgment of the District Court in Frýdek-Místek No. 42 C 9/2012 - 238 of 25 April 2014.

[28] Judgment of the District Court in Karviná, No.28 C 627/2011 - 107 of 29 October 2013 - "The expert institute pointed out the existing duopoly in the supply of rental flats in Český Těšín, i.e. the dominant position of two landlords (RPG Byty, s.r.o. and CPI BYTY, a.s.), where only small flat owners form the so-called competitive edge. Thus, in a given location, the price is not created by the balance of supply and demand; the duopolistic firms prefer to maintain the price level even at the cost of a smaller number of rentals."

preme Court (26 Cdo 4494/2015 of 03 May 2017, 26 Cdo 3574/2018 of 28 August 2019, etc.), the courts, respond/or experts should have taken into account the fact that the flats belong to one owner when determining the rent by comparison and should not have excluded from the comparison the rent in flats owned by the municipality, and should have taken into account a number of other facts (e.g. vacancy of the flats). However, such analyses did not usually take place in the context of judicial decision-making or expert examination.

To the findings and conclusions made, it may perhaps be added that the legal rules concerning rent and rents are the result of political considerations which cannot be value-free. It is, of course, politically acceptable to give preference to interest groups, but this should not lead to the erosion of fundamental constitutional and legal guarantees, as the authors believe has happened in this case. Moreover, in the case of landlords with a dominant position and excessive rents, there is an economic inefficiency (deadweight costs). The potential cost is not only borne by the tenants[29] who pay the potential excessive rents but is a problem for the whole economy. In any case, the issue of excessive prices[30] (rents) as a competition phenomenon[31] was rather implicit in the article. It would be useful to address this issue directly in future research.

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[30] See AKMAN P. and GARROD L., When are Excessive Prices Unfair? Journal of Competition Law & Economics, Volume 7, Issue 2, June 2011, Pages 403–426. https://doi.org/10.1093/joclec/nhq024.

[31] For further reading, see KATSOULACOS Y., JENNY F. (Eds.). Excessive Pricing and Competition Law Enforcement. International Law and Economics Series, Springer, 2018, 284, ISBN 978-3-319-92830-2.

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SECTION V
EUROPEAN AND INTERNATIONAL LEGAL ASPECTS OF DOING BUSINESS

The proposed Corporate Sustainability Due Diligence Directive and its provisions on civil liability and private international law in particular

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Abstract: *The newly adopted proposal for a Corporate Sustainability Due Diligence Directive introduces for the first time in EU law the duty of undertakings to perform corporate due diligence on environmental and human rights matters. The aim of the present paper is to examine the provisions of the proposed Directive on civil liability and private international law issues. The paper first provides a brief overview of the proposal, which serves as an essential background, and then focuses on the interpretation of the provisions on civil liability, based on their wording, aim and scope, existing literature on due diligence and case law. The rules are also examined in context with advancements in international and national law. The study concludes that, although several issues remain uncertain or to be decided by national law, the introduction of civil liability and private international law rules will substantially facilitate multi-jurisdictional claims against corporations on environmental and human rights matters. The paper contributes to the discussion on forthcoming European legislation on corporate due diligence by assessing private law issues which have been scarcely investigated in literature.*

Keywords: *applicable law, civil liability, due diligence, Corporate Social Responsibility*.

INTRODUCTION

The concept of due diligence is to a great extent unknown in EU and national law, as it originates in international human rights law, and more specifically the UN Guiding Principles on Business and Human Rights[1] and the OECD Guidelines for Multinational Enterprises[2], two soft law instruments for business

[1] UNITED NATIONS Guiding Principles on Business and Human Rights 2011 [online]. United Nations Human Rights, Office of the High Commisioner. Available from: https://www.ohchr.org/sites/default/files/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.

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practices. The newly adopted proposal for a Corporate Sustainability Due Diligence Directive (CSDD)[3] introduces for the first time the duty to perform corporate due diligence on environmental and human rights matters. The proposal comes as a supplement to the proposed Corporate Sustainability Reporting Directive[4] and should be seen in context with the general developments in EU sustainability policy and related national legislation on due diligence. Corporate due diligence rules have been introduced in France, Germany, Norway (EEA country) and to a limited extend, the Netherlands (only with regard to child labour), while the introduction of horizontal legislation is also discussed in Belgium, Sweden and Luxembourg[5].

The aim of the present paper is to identify and suggest solutions to potential interpretation issues in the proposed CSDD provisions on civil liability, applicable law and jurisdiction. In doing so, the study uses the methods of linguistic and teleological interpretation, as well as reference to existing literature and comparison to national law provisions. In the first Section, the paper provides a brief overview of the proposed Directive and presents some of its terms which are essential for the interpretation of its civil liability provisions. Section 2 presents the rules on civil liability and discusses interpretation issues. Section 3 investigates the applicable law rules and addresses the issue of jurisdiction. The paper concludes with some final remarks on the uncertainties and the significance of the proposed Directive.

1. OVERVIEW OF THE PROPOSAL

1.1. Scope of application, nature of obligations and enforcement mechanisms

The new Directive, when adopted, will capture European companies of more than 500 employees and net worldwide turnover of over EUR 150 million. The scope will later be expanded to smaller companies in high-impact sectors,

through corporate civil liability. International and Comparative Law Quarterly. 2020, 69 (4), 789–818.

[3] Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (CSDD) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC 0071.

[4] Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No. 537/2014, as regards corporate sustainability reporting [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0189.

[5] Nonetheless, the introduction of mandatory legislation on due diligence without more measures for effective monitoring and relief mechanisms is contested, see SCHILLING-VACAFLOR, Almut and Andrea LENSCHHOW. Hardening foreign corporate accountability through mandatory due diligence in the European Union? New trends and persisting challenges. Regulation & Governance. 2021. doi:10.1111/rego.12402.

such as textiles and minerals. Third-country companies that generate a net turnover of more than EUR 150 million in the EU will also be covered.[6]

The main obligation introduced by the proposed Directive is the duty of companies to integrate due diligence into their corporate policies. More specifically, companies are required to identify, prevent, mitigate, bring to an end and minimize potential and actual adverse human rights and environmental impacts of their own operations, the operations of their subsidiaries, as well as at the level of their 'established direct or indirect business relationships in their value chain'. The explicit inclusion of subsidiaries provides a solution to the problem of liability of parent company for the actions of its subsidiaries, which has troubled national courts.[7] The proposal has already been subject to some criticism for its limited scope and its vagueness on environmental due diligence and climate change mitigation[8], which is a relatively new field[9], in contrast to human rights due diligence, in which there has already been some practical experience with the application of the UN Principles Further guidance on the exact actions that a company has to take for each step of the due diligence process ('identify'- 'prevent'- 'bring actual impacts to an end') is provided in Articles 6 to 8 of the proposed Directive.

The due diligence process will be described in a company policy document, which will include the company's general approach, a code of conduct with concrete rules and principles, as well as description of specific processes and measures.

Moreover, companies will have to establish and maintain an internal complaints procedure, monitor the effectiveness of their due diligence mechanism and publish reports on their processes, which will be incorporated in the CSR report.[10] Member States will have to appoint appropriate supervising authorities with the power to impose effective, proportionate and dissuasive sanctions for breaches of due diligence obligations. A European network of supervisory authorities is also established in order to safeguard a coordinated approach on the Directive.

[6] Article 2 of the CSDD proposal.
[7] See BUENO, Nicolas and Claire BRIGHT, op.cit., 808.
[8] ECCJ (EUROPEAN COALITION FOR CORPORATE JUSTICE). European Commission's proposal for a Directive on Corporate Sustainability Due Diligence: A comprehensive analysis [online].2022. [viewed 26 August 2022]. Available from: https://corporatejustice.org/ publications/analysis-of-eu-proposal-for-a-directive-on-due-diligence/, p. 9.
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[10] Article 11 of the CSDD proposal.

1.2. The notion of 'established direct and indirect business relationships' and the role of contractual assurances

As already mentioned, the companies will have to perform due diligence at the level of their 'established direct or indirect business relationships in their value chain', a new concept which significantly broadens the number of agents for the actions of which the company may be held responsible. The exact meaning of the term 'established business relationship' is also critical for the establishment of civil liability. According to Article 3 (f) of the proposed Directive, it means 'a business relationship, whether direct or indirect, which is, or which is expected to be lasting, in view of its intensity or duration and which does not represent a negligible or merely ancillary part of the value chain'. As explained in Recital 8, the legislator wishes to cover the whole range of activities in the value chain, from design and extraction to the end of life of the product.

The notion of 'established business relationship' has been criticized by some commentators as departing from the risk-based approach that the UN Guiding Principles propose and creating the danger that certain human rights violations of minor partners remain outside the scope of the Directive.[11] Other commentators argue that the company should only be liable for its own actions.[12] However, taking into account the costs and effort that companies will have to take to ensure compliance, the notion of 'established business relationship' appears to be a reasonable boundary to due diligence obligations.

One of the main tools that companies will be obliged to use during their due diligence process are contractual clauses in their business transactions, in order to ensure that their business partners are bound by the company's code of conduct. What is more, companies will also have to follow up on the actions of their partners and they may use third-party verification in this respect. Special care is taken on the position of SMEs, in an effort not to put an unbearable burden on their relations with larger companies. The European Commission is bound to implement guidance on model contractual clauses and their use.[13]

[11] OHCHR. OHCHR Feedback on Proposed Directive on Corporate Sustainability Due Diligence. Office of the UN High Commissioner for Human Rights[online]. 2022. [viewed 26 August 2022]. Available from: https://www.ohchr.org/sites/default/files/2022-05/eu-csddd-feedback-ohchr.pdf, p.3. ECCJ, op.cit., p. 5.

[12] ANDERSEN, Paul Krüger, Niklas ARVIDSSON et al. Response to the Proposal for a Directive on Corporate Sustainability Due Diligence by Nordic and Baltic Company Law Scholars [online]. 2022. [viewed 26 August 2022]. Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4139249.

[13] Article 12 of the CSDD proposal.

2. RULES ON CIVIL LIABILITY

2.1. A new liability rule

The introduction of civil liability provisions in due diligence legislation has been advocated by various studies, due to the inefficiency of currently available legal remedies, especially for victims of human rights abuses.[14] The Directive aims inter alia to minimize distortions that have been created by differing national laws on civil liability.[15] As already mentioned, national law provisions on due diligence are mainly in place in France and Germany: the French 'Vigilance law' of 2017 includes liability rules[16] and resembles the discussed CSDD proposal; according to the French law, liability for breach of due diligence obligations will be decided by general liability provisions in national law[17].The 2021 German 'Act on Corporate Due Diligence Obligations in Supply Chains' explicitly excludes liability, although it is accepted that it has a concrete effect on the national civil liability regime.[18]

The proposal includes specialized rules on civil liability of companies. A new legal basis for liability for damages is created in Article 22 (1); if the company fails to comply with its obligations to prevent and bring to an end actual and potential adverse impacts of its activities[19] and, as a result of this failure, an adverse impact has occurred and led to a damage, the company should be liable for that damage.

The liability established by the Directive will be without prejudice to the civil liability of the company's subsidiaries or established business partners.

[14] See, for example, McCORQUODALE, Robert and Justine NOLAN. The Effectiveness of Human Rights Due Diligence for Preventing Business Human Rights Abuses. Netherlands International Law Review. (2021) 68, 455–478, 475. EUROPEAN LAW INSTITUTE. Business and Human Rights: Access to Justice and Effective Remedies [online]. 2022. [viewed 26 August 2022]. Available from: https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/ELI_Report_on_Business_and_Human_Rights.pdf, p. 27.

[15] CSDD proposal, p. 12-13.

[16] See SAVOUREY, Elsa and Stéphane BRABANT, S. The French Law on the Duty of Vigilance: Theoretical and Practical Challenges Since its Adoption. Business and Human Rights Journal. 2021, 6(1), 141-152, 149. doi:10.1017/bhj.2020.30.

[17] Conseil Constitutionnel, France of 23 March 2017, No. 2017-750 DC. In Conseil Constitutionnel [accessed on 2022-28-10] Available from https://www.conseil-constitutionnel.fr/en/decision/2017/2017750DC.htm, para. 27. However, in this decision the French Consitutional Council has annuled some of the Vigilance law provisions on sanctions because of ambiguity with regard to imposed obligations.

[18] HOFFMANN, Sonja, Thomas HELCK, Christian M. THEISSEN and Christoph ZUSCHLAG. The New Corporate Due Diligence Act: Potential Liability under Civil Law and Administrative Law. White & Case. [online]. 2022. [viewed 26 August 2022]. Available from: https://www. white-case.com/insight-alert/new-corporate-due-diligence-act-potential-liability-under-civil-law-and.

[19] Only breaches of Article 7 and 8 lead to liability.

Moreover, all national EU or national law provisions that provide for stricter liability remain in place.

2.2. Legal nature and conditions of civil liability

The first question that arises with regard to the liability rule established in the CSDD proposal is whether it can be categorized as strict or fault-based liability. Although at first glance the provision seems to introduce strict liability, it is actually fault-base liability[20]; companies are required to take appropriate measures, and appropriate measures include measures that are reasonably available to the company, taking into account the characteristics of the specific case, as Article 3 (q) stipulates. The requirement to prove the unreasonableness of the measures, in order to establish a due diligence failure, points to fault-based liability.[21]

Therefore, the liability regime can be categorized as a type of tort-based liability and national law provisions on tort will be called upon to supplement the unresolved issues of the Directive. National rules on tort differ significantly, as some jurisdictions such as Germany, Portugal[22] and Greece require separate proof of fault. The proof of causation may also entail difficulties for victims, as the application of different theories of causation may result in different outcomes.[23] Nevertheless, the provisions may generally serve to interpret national rules on the 'duty of care', as it has already been suggested in the comments for the 2021 German Act.[24]

The most important issue on the application of civil liability rules is the burden of proof: Recital 58 clearly stipulates that the burden of proof should be decided by national law. The failure to regulate the burden of proof has been highlighted as the main deficit of the proposed Directive: unless otherwise specified by national law, the burden of proof is left to the claimants, who will have to prove that the company did not take 'appropriate' measures to prevent and bring to an end its adverse impacts and this failure has caused them damage.

[20] See BRABANT, Stéphane, Claire BRIGHT, Noah NEITZEL and Daniel SCHONFELDER. Enforcing Due Diligence Obligations: The Draft Directive on Corporate Sustainability Due Diligence (Part 2). VerfBlog. 022/3/16. [online]. 2022. [viewed 26 August 2022]. Available from: https://verfassungsblog.de/ enforcing-due-diligence-obligations/, DOI: 10.17176/20220316-121227-0.ECCJ, op. cit. p. 20.

[21] See DE OLIVEIRA, Maria Inês. Civil liability for breach of due diligence duties – First thoughts on the comparison between the European Parliament recommendations and the European Commission proposal. NOVA BHRE. [online]. 2022. [viewed 26 August 2022]. Available from: https://novabhre.novalaw.unl.pt/elementor-6458/.

[22] Ibid.

[23] SAVOUREY, Elsa and Stéphane BRABANT, op.cit.

[24] HOFFMANN, Sonja et al., op.cit.

This fact may render judicial action very difficult for victims of environmental and human rights abuses[25], especially taking into account that the claimants will have limited access to the company's internal documents[26].

In the absence of related provisions in the proposal, several significant issues such as limitation periods for action, liability for non-financial damage and injunctive measures will also have to be decided by national law. As already mentioned, Member States are in principle allowed to introduce or maintain rules on stricter liability: however, the above mentioned unsettled issues, along with other vague notions such as the one of 'established relationships in the value chain', substantially increase the danger of divergent implementation among Member States and different approaches on civil liability in theory and judicial practice.

2.3. The 'contractual assurances' defence of Article 22 (2)

The company has the opportunity to waive its liability for the activities of its indirect partners, if it proves that it has taken all due diligence measures and, more specifically, contractual assurances from its direct partners, accompanied by measures to verify compliance.[27] The exoneration from liability will not apply if it was unreasonable to expect that the action actually taken was adequate to prevent and bring to an end adverse impacts. Other factors that should be taken into account are the company's efforts to comply with recommendations of supervising authorities, investment and collaboration with other entities. The liability waiver only applies to indirect 'established business relationships'.

The above mentioned provision has been criticized for overemphasizing the role of contractual assurances and facilitating companies to avoid liability by offloading it to third parties.[28] On the other hand, it is argued that the condition on 'reasonableness' will require the judge to focus on the substantive nature of the due diligence measures that the company has taken and not only examine whether contractual assurances have been secured.[29] In any case, the provision only mentions contractual measures and they should suffice for the exoneration from liability for the actions of indirect partners.

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[25] BRABANT, Stéphane et al., op.cit. See also, PACCES, Alessio. Supply Chain Liability in the Corporate Sustainability Due Diligence Directive Proposal. Oxford Business Law Blog [online]. 2022. [viewed 26 August 2022]. Available from: https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/supply-chain-liability-corporate-sustainability-due-diligence, who thinks that leaving the burden of proof to national law is a 'fatal mistake and outlines the danger that companies will rearrange their supply chains in order to evade liability.

[26] ECCJ, op.cit., p. 20.

[27] Since Article 22 (2) makes a direct reference to Articles 7(2), (b), 7(4), and 8(3)(c), 8(5)

[28] ECCJ, op.cit., p.20. The OHCHR, op.cit., also finds that too much emphasis is put on the description of actions, rather than a flexible, principle-based approach.

[29] BRABANT, Stéphane et al., op.cit.

3. PRIVATE INTERNATIONAL LAW ISSUES

3.1. Rule on applicable law

The proposal also includes a private international law provision, in order to ensure that due diligence rules will apply even when the applicable law is not the law of the Member State: National legislators are obliged to implement the Directive as law of overriding mandatory application, which-according to private international law-will always apply, irrespective of the national law applicable to the substance of the dispute. The mandatory application of due diligence rules should be understood as capturing the whole text of the Directive, not only its civil liability regime.[30] This provision will substantially facilitate civil liability actions in relation to the existing Rome II Regulation[31] which would otherwise be fully applicable, as it will allow for the Directive to apply even when the damage has occurred outside the EU.

However, as the previous discussion on civil liability has demonstrated, several vital issues are left to national law. Therefore, the determination of applicable law remains more than relevant.[32] According to Article 4 (1) of the Rome II Regulation, the law applicable to torts is the law of the country in which the damage occurs. The court also has the option to use the law of the country which is manifestly more closely connected to the tort. Therefore, judges may be called to use in a supplementary way the law of the country in which the environmental damage occured or the law of the domicile of the victims of human rights abuses.

Litigation on civil liability for extraterritorial human rights and environmental abuses of EU companies has been so far minimal.[33] Despite the uncertainties that the decision on applicable law will cause, the fact remains that the application of uniform EU substantial provisions on due diligence breaches committed outside the EU will significantly impove redress for victims.

3.2. Jurisdiction issues

No rules on jurisdiction are included in CSDD proposal, despite previous discussions on the contrary. This will mean that general rules on jurisdiction will

[30] HO-DAC, Marion. Brief Overview of the Directive Proposal on Corporate Due Diligence and PIL. The European Association of Private International Law (EAPIL) [online]. 2022. [viewed 26 August 2022]. Available from: https://eapil.org/2022/04/27/brief-overview-of-the-directive-proposal-on-corporate-due-diligence-and-pil/.

[31] Regulation (EC) No. 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II) [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A32007R0864.

[32] HO-DAC, Marion, op.cit. who also observes that the CSDD proposal does not establish a 'complete and fully uniform regime of liability.

[33] A 2019 study has shown that only two cases of extraterritorial damage caused by EU companies have been succesfully brought before EU courts, see EUROPEAN LAW INSTITUTE, op.cit., p.33.

apply, as prescribed by the Brussels I bis Regulation.[34]

Companies domiciled in the EU will be sued in the courts of the Member State of their domicile, according to the general rule of Article 4 Brussels I bis Regulation. Article 63 of the Regulation allows for a more flexible approach, as the court may opt for the place of statutory seat, central administration or principal place of business as domicile. Nevetheless, if claimants decide to jointly sue subsidiaries or business partners of the company, who are domiciled outside the EU, the Brussels I bis Regulation will not apply and jurisdiction will be decided by national private law rules of the forum. This difference in treatment is regarded as justified, as subsidiaries and business partners may not be subject to the substantial liability rules of the Directive.[35]

In contrast, it will not be possible for non-EU based companies to be sued before EU courts, even when they are subject to substantive due diligence obligations of the Directive. This fact results to considerable limitations on the ability of injured parties to sue non-EU companies before EU courts.[36]

However, some examples of cases against non-EU defendants that have been sucessfully litigated in the EU may be found in general human rights and environmental litigation. EU courts have based their jurisdiction mainly on arguments on the parent company's duty to supervise and prevent the actions of its subsidiaries.[37]

CONCLUSION

The proposal introduces due diligence obligations for human rights and environmental matters for the first time in EU law. The provisions on civil liability establish a uniform, though incomplete, regime that will create a level playing field for European companies. A number of important issues will be decided by national law. The rule on applicable law will significantly facilitate victims of environmental and human rights abuses to seek redress before European courts. No rules on jurisdiction are included, which will mean that the general EU rules will continue to apply. The Directive is still at the proposal stage, so more research will be needed in the future in order to clarify the practical consequences of its application.

Despite its weaknesses and uncertainties, the proposed Directive is a

[34] Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast), OJ L 351, 20.12.2012, p. 1.
[35] HO-DAC, Marion, op.cit.
[36] Ibid.
[37] EUROPEAN LAW INSTITUTE, op.cit., pp. 46-48. For the general approach to jurisdiction on human rights violations see also AUGENSTEIN, Daniel and JÄGERS, Nicola. Judicial remedies: the issue of jurisdiction. In: Juan José ALVAREZ RUBIO and Katerina YIANNIBAS, eds. Human Rights in Business: Removal of Barriers to Access to Justice in the European Union. London and New York: Routledge, 2017, pp. 220–245.

groundbreaking legislative instrument, capable of solving many of the problems that injured parties now face in pursuing claims related to corporate social responsibility and will most probably increase related litigation throughout the EU. Furthermore, since the Directive is likely to indirectly affect a great number of companies which are affiliated to EU companies as business partners, it is reasonable to expect that it will bring a change towards a more comprehensive framework on the integration of environmental and human rights in worldwide business.

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What are the risks of non-fungible tokens (NFTs) from intellectual property law perspective?

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Abstract: *Non-fungible tokens, called NFTs for short, are not only one of the biggest game changers in the digital marketplace, but they are also raising a lot of attention in the field of intellectual property law. The NFT boom that began in 2021, particularly in the art world, has already caused numerous intellectual property disputes. This paper focuses on analysing various issues related to copyright, trademarks, and the problem of potential infringement of these rights in the case of NFTs. The starting point is to identify what NFT is in the first place. Can NFT be used to transfer copyright, or could it be considered as a form of license? If someone makes an NFT without the author's consent, is it a copyright breach? This paper aims to find out whether NFTs can be considered unauthorized copies of an original work or product under applicable law and whether a copyright infringement claim can be raised. This will be done in particular by outlining the legal argumentation of the ongoing lawsuits. Therefore, this paper's contribution should be to set out possible legal risks to those operating in the art market or those whose trademarks have not yet been extended to the metaverse.*

Keywords: *copyright, intellectual property, non-fungible tokens, trademarks.*

INTRODUCTION

Non-fungible tokens, or NFTs, are nothing new, but in early 2021 they suddenly took over the world[1], especially the art world. Could it be because the pandemic moved almost everything to a virtual environment in the year 2020? NFT sales in 2021 reached $24.9 billion, up from just $94.9 million a year earlier.[2] NFTs have made it to the global auction scene. In March 2021, the auction house Christie's made history with the ground-breaking sale of the digital artist

[1]KAMPAKIS, Stylianos. Non-fungible Tokens as an Alternative Investment – Evidence from CryptoPunks. *The Journal of The British Blockchain Association* [online]. 2022, 5(1), 1–12 [viewed 15 September 2022]. ISSN 2516-3957. Available from: doi:10.31585/jbba-5-1-(2)2022.
[2]NFT sales hit $25 billion in 2021, but growth shows signs of slowing. *Reuters* [online]. 11 January 2022 [viewed 15 September 2022]. Available from: https://www.reuters.com/markets/europe/nft-sales-hit-25-billion-2021-growth-shows-signs-slowing-2022-01-10/.

Beeple's record-smashing NFT "Everydays: the First 5000 Days" for $69 million.[3] Non-fungible tokens opened a new market for digital art. NFTs dominated the art world and continued into the consumer space of fashion, film and music.[4] Also, in March 2021, Twitter CEO Jack Dorsey sold NFT of his first ever tweet titled "Just Setting up my Twttr" for over $2.9 million.[5]

The NFT boom has already caused several intellectual property disputes. This paper will therefore focus on various issues related to the possible infringement of these intellectual property rights in the case of NFTs. To examine this legal issue, the method of analysis will be used. First, it will be necessary to specify what NFTs actually are. The aim of this article is to determine whether NFTs can be considered unauthorized copies of an original work under applicable law and whether a copyright infringement claim can be raised. We will therefore explore what and how it is being resolved in selected ongoing lawsuits. For this purpose, I have selected four court cases, one of which has already been closed by a court decision and three of which are still pending. Each of them focuses on a slightly different issue across the intellectual property spectrum, from copyright to trademarks. The contribution of this paper should be to identify possible legal risks.

1. WHAT EXACTLY IS NFT?

An NFT is a sort of digital certificate for verifying asset ownership using blockchain technology. Each NFT contains a unique identifier and metadata referencing physical or digital assets that cannot be replaced or replicated, so NFTs should be used to detect and track ownership of both native digital and physical tokenised assets.[6]

Before NFT, it was difficult to determine the originality of digital artworks. Moreover, it was very difficult to prove these works' ownership or to transfer ownership. NFTs have changed this by changing the art world as well.[7]

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[3] Digital Art & NFTs. *Christie's Auctions & Private Sales | Fine Art, Antiques, Jewelry & More* [online]. [no date] [viewed 15 September 2022]. Available from: https://www.christies.com/auctions/christies-encrypted#overview_Nav.

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The NFT is basically just a code that is written into the blockchain. It consists primarily of a token ID, a number that is generated when the token is created, and of an address of the contract's address on the blockchain. It is the combination of these two elements contained in the token that makes it unique. The NFT is simply these two numbers. However, there may also be other information included in the contract. To make it easier to link the NFT to its creator, the creator's wallet address is often included. Most NFTs also commonly include an URL to the place where the underlying piece can be accessed. The NFT may, of course, contain the title of the work, the name of the artist, and many other details. The token is not the work itself but rather a unique digital signature that is associated with the underlying work.[8]

When we talk about the creation of an NFT, we are talking about the "minting of a work", however, this is simply the creator utilizing the underlying piece to generate the aforementioned assigned number that is then encoded into the blockchain.

NFTs are often compared to a signed copy of an artwork. This is imprecise, since an NFT is not itself a copy, but rather a signed receipt for an artwork, where the ownership of the artwork itself is not involved, but rather the ownership of the receipt.[9]

Of course, there is also NFT, in which an entire underlying piece of artwork is transferred directly to the blockchain. Here we would indeed be talking about ownership of the artwork. However, there are not many of these cases because the expense of storing data on the blockchain is so high.

So, from the explanation above, it is obvious that an artwork on the one hand and a token on the other hand are two different things.

2. NFT, COPYRIGHT AND COPYRIGHT ASSIGNMENT

Ownership of NFT does not automatically mean all rights to the artwork. The underlying artwork may, of course, be copyright protected. How the NFT holder may dispose of the relevant artwork should be properly regulated by the license agreement. Ideally, the author of the artwork or the auction platform would link the license agreement to the NFT metadata. However, how to make this link is still a matter of discussion.

Currently, most NFTs on the market do not include a copyright assignment, but we can still see cases where a seller offers a token with a copyright assignment of the underlying work. However, what should such a transfer of rights look like to be legally sufficient?

According to Article 5(2) of the Berne Convention, "the enjoyment and

[8] GUADAMUZ, Andres. The treachery of images: non-fungible tokens and copyright. *Journal of Intellectual Property Law & Practice* [online]. 2021, 16(12), 1367–1385 [viewed 15 September 2022]. ISSN 1747-1540. Available from: doi:10.1093/jiplp/jpab152.
[9] Ibid.

the exercise" of copyright shall not be subject to any formality.[10] This suggests that the duration of the copyright does not depend on the fulfilment of formal conditions. The rights will apply as long as the artwork is subject to the protection of national laws and treaties. However, some jurisdictions require certain formalities concerning the assignment of such rights. As the extent of these formalities is not harmonised, it is up to each jurisdiction to determine the conditions.[11]

For example, in the United Kingdom, the Copyright, Designs and Patents Act from 1988 (CDPA) requires a transfer of copyright that is "in writing signed by or on behalf of the assignor".[12] But is it even possible for a token to meet these requirements?

In Czech law, both personal rights (Section 11(4) of the Copyright Act[13]) and commercial copyrights (Section 26(1) of the Copyright Act) are non-transferable. A licence agreement is the only way an assignee can obtain the right to exercise intellectual property rights. If an exclusive licence is granted, then a written form is required. Moreover, the authorisation to exercise those rights may be limited or granted only for a certain territory. A simple written electronic form (Section 7 of Act No. 297/2016 Coll.) is also considered a written form between individuals. Thus, it can also be two emails containing the so-called simple electronic signatures of the persons acting and in which the parties agree on the use of the copyrighted work.[14]

In theory, any type of contract can be encoded into a smart contract, but if a coded token can meet the written formalism at all is likely to be questionable in all jurisdictions so far.

Apart from these as yet unanswered questions, whether it is even possible to transfer copyright using NFT to someone else or not, it is generally essential to pay attention to what the creators of NFTs and platforms claim.

Let's take a closer look at the Bored Ape Yacht Club (BAYC), the world's most successful NFT collection, a series of collectable "one-of-a-kind" apes, which proclaims that the buyer will receive a licence for personal and commercial use of each version of their ape. The license, existing in this case in the platform, not in the NFT itself, claims that it grants the owners of this licence an unrestricted worldwide licence to use, copy, and display the licensed work.

In June of this year, a dispute between artist Ryder Ripps and Yuga Labs,

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[10] Berne Convention for the Protection of Literary and Artistic Works Paris Act of July 24, 1971, as amended on September 28, 1979 [online]. World Intellectual Property Organization (WIPO). Available from: https://wipolex.wipo.int/en/text/283693.

[11] See note 8.

[12] Ibid.

[13] CZECH REPUBLIC Act No. 121/2000 Coll., the Act on Copyright, on Rights Related to Copyright and on Amendments to Certain Acts [zákon č. 121/2000 Sb., zákon o právu autorském, o právech souvisejících s právem autorským a o změně některých zákonů].

[14] SRSTKA, Jiří a kol. *Autorské právo a práva související*. 1st ed. Praha: Leges, 2017. ISBN 9788075022400.

creators of the NFT Bored Ape Yacht Club collection, came to court. Ripps created his own competing Bored Ape collection and Yuga Labs responded with a lawsuit. Logically, they would claim copyright infringement against Ripps, but the suit does not actually address copyright at all. Yuga Labs is suing for a false designation of origin, false advertising, cybersquatting, trademark infringement, and unfair competition. Ripps states that the terms of ownership set by Yuga Labs to BAYC token holders are unclear and do not meet current copyright standards.[15] Therefore, the question is, does this most successful NFT collection have copyrights? Do they have them registered?

3. COPYRIGHT INFRINGEMENT

With the rise of the NFT wave, cases of possible copyright infringement have begun to emerge. Most of these cases were resolved out of court, usually by withdrawing the token from the sale.

One of the first copyright infringement lawsuits is currently ongoing in the U.S. Musician Jay-Z and Damon Dash co-founded the Roc-A-Fella (RAF) label, under which they released the album Reasonable Doubt. Dash decided in June 2021 to launch an NFT Reasonable Doubt. However, RAF owns the copyright to the album, where Dash is now only a minority shareholder. RAF, therefore, sued Dash claiming copyright infringement. A temporary restraining order was issued to stop sales and the case is currently still ongoing.[16]

In this case, was there copyright infringement in the minting of NFT? The answer to this question seems clear. After all, there must be copyright infringement in minting NFTs without proper authorisation. However, if one tries to analyse what an NFT is and how it is created, doubts start to arise.

Since the token is not the work itself, but only the codes that were created using the underlying work, it is not possible to see it as a copy of the work. As for the rights to use the work, perhaps the right to share the work with the public can be considered.

The exclusive rights granted to the author of a work by the Czech Copyright Act[17] include the reproduction (Section 13), distribution (Section 14), rental (Section 15) and lending (Section 16), display (Section 17) and communication to the public (Section 18), and the right to perform any of the above activities. It seems that only the right of communication to the public could be infringed by the link to the underlying work in the NFT, as in such a case, a causal connection

[15] GUADAMUZ, Andres. Do Bored Apes have a copyright problem? *TechnoLlama* [online]. 30 August 2022 [viewed 15 September 2022]. Available from: https://www.technollama.co.uk/do-bored-apes-have-a-copyright-problem.

[16] See note 8.

[17] CZECH REPUBLIC Act No. 121/2000 Coll., the Act on Copyright, on Rights Related to Copyright and on Amendments to Certain Acts [zákon č. 121/2000 Sb., zákon o právu autorském, o právech souvisejících s právem autorským a o změně některých zákonů].

can be identified.

The courts' approach to hyperlinks could probably be compared to how copyright infringement cannot be applied in the case of NFTs. This is because, like the NFT, hyperlinks are made up of letters and numbers that link to another web page. The NFT itself, like a hyperlink, is not a copy. The user is simply redirected to another web page. As a result, the link as such is not a copyright infringement, but of course, it may link to content that may infringe copyright.[18]

4. RECENT LAWSUITS

Copyright and NFT issues are becoming increasingly frequent and it is not surprising that several lawsuits have popped up in recent months. Let's take a look at some of them.

4.1. Julian Sander case

The most recent, and probably the closest to us, is a case from the spring of this year, when Julian Sander, a gallery owner from Cologne, wanted to preserve the legacy of his great-grandfather, the photographer August Sander, which consisted of over 10,000 artworks, using the NFT and make it available to the public.[19] August Sander was one of the most important photographers of the 20th century. However, the copyright to these works is held by the non-profit Foundation SK Stiftung Kultur der Sparkasse KölnBonn, which acquired the entire collection, including the copyright, in 1992 from Gerd Sander, the grandson of August and father of Julian. The Foundation holds these rights until 2034, 70 years after the photographer's death. After that time, the creator's copyright expires, and the artworks become freely usable by anyone.

Julian Sander has made his great-grandfather's achievements available for free on the OpenSea sales platform, with the buyer only having to pay the administrative costs of minting the NFT. The Foundation, of course, has objected to this.

Julian Sander claims that the Foundation is not responsible for the distribution of works on the world market. He further argues that this is a case of "fair use", the Anglo-American law concept according to which protected works can be used without the author's permission in certain circumstances. In the present

[18] BEHZADI, Emily. The Fiction of NFTs and Copyright Infringement – University of Pennsylvania Law Review. *University of Pennsylvania Law Review – Founded in 1852 as the American Law Register, the University of Pennsylvania Law Review is the nation's oldest law review.* [online]. [no date] [viewed 15 September 2022]. Available from: https://www.pennlawreview.com/2022/04/12/the-fiction-of-nfts-and-copyright-infringement/.

[19] SEYMOUR, Tom. Major court battle looms over NFT launch of August Sander photographs. *The Art Newspaper - International art news and events* [online]. 6 May 2022 [viewed 15 September 2022]. Available from: https://www.theartnewspaper.com/2022/05/06/major-court-battle-looms-over-nft-launch-of-august-sander-photographs.

dispute, the Foundation is primarily referring to its exclusive right to use the works in the archive.

Under German law, the Foundation owns the right to reproduce, distribute and make works available to the public. A licence agreement is required to transfer these rights. The main question in the Sander litigation is, therefore, whether and what rights Julian Sander had or whether he could create, promote, sell and thus "use" the NFTs within the meaning of the Copyright Act without the consent of the Foundation. What will be important in this case is above all the wording of the contract by which the copyright was sold to the Foundation in 1992. However, we will have to wait for the outcome of the legal analysis of the competent court.

4.2. "Pang Hu Getting Vaccinated" case

The first judgment in a copyright infringement dispute concerning the NFT was issued by a Chinese court in Hangzhou in April 2022. In the judgment, the court addressed several issues relating to copyright in relation to NFTs as well as the obligations of NFT platforms.

An NFT of a work entitled "Pang Hu Getting Vaccinated" was created, while the rights to that work belong to the plaintiff in this litigation. The NFT was uploaded to the platform that is the defendant in this case. The plaintiff contacted the defendant, demanding that the work be removed from the platform and from the blockchain as well as destroy the infringing NFT. The defendant responded that it was his responsibility to review such a copyright infringement notification and remove the work from the platform, which is what he did. The court concluded that the defendant, as a platform, had a higher obligation of diligence and should be responsible for infringement due to the nature of the NFT, meaning that it should have taken more significant actions to verify the intellectual property rights prior to release.

The critical issue for the court was to assess what specific right of the copyright holder was infringed by the author of the NFT. Upon examination, the court found that the right to transmission via an information network had been infringed and sanctioned the defendant's platform with a fine.

The judgment raised many legal questions but did not answer all of them as we would have needed.[20]

4.3. Nike vs. StockX

Nike filed a lawsuit against the company StockX in April 2022, accusing

[20] BAIYANG, Xiao. Shenzhen QiCeDieChu Cultural and Creativity Co. *v* Hangzhou Bigverse Technology Co. (2022). *Journal of Intellectual Property Law & Practice* [online]. 2022 [viewed 15 September 2022]. ISSN 1747-1540. Available from: doi:10.1093/jiplp/jpac064.

it of trademark infringement, dilution, unfair competition, counterfeiting and misleading advertising in relation to its sale of NFTs connected to images and physical versions of Nike shoes without obtaining its permission. Nike also alleges that StockX sells these NFTs at significantly high prices to consumers who assume or may assume that Nike authorizes these assets.

In its statement, StockX says that Nike's arguments do not respect settled doctrines of trademark law and, in particular, completely misunderstand the function the NFTs intend to perform in this case.

StockX says that the NFTs in dispute are, in fact, just "claim tickets" or "digital receipts" used to track ownership of a specific physical Nike product, the authenticity of which StockX purportedly verified through its "proprietary, multi-step verification process".[21]

4.4. Hermès vs. Rothschild

In another case, the luxury design house Hermès is suing artist Mason Rothschild in a U.S. court for infringement of the "Birkin" trademark and other related rights.

Rothschild created digital replicas of luxury Hermès Birkin handbags and used a collection of 100 NFTs called "MetaBirkins" to authenticate the digital images.

In its reply, Rothschild argued that the digital images of the Birkin handbags were art and therefore entitled to protection. Rothschild claims that the U.S. Constitution gives him the right to create and sell artwork depicting Birkin bags, just as it gave Andy Warhol the right to create and sell artwork depicting Campbell's soup cans[22].

Hermès argued that by selling MetaBirkins on several different social media and marketing channels, Rothschild was using the MetaBirkins name as a source identifier. The court concluded that Rothschild's work could be a form of artistic expression. According to the court, NFTs are merely code that indicates the placement of a digital image for authentication purposes and do not convert the image into merchandise.

However, the court stated that the use of the name MetaBirkins could be misleading and deceptive if it caused the public to believe that Hermes had authorized the infringing use. The court pointed to instances where consumers on the MetaBirkins Instagram page expressed genuine confusion that Hermès was somehow associated with the NFT MetaBirkins collection. Magazines such as

[21] A Running List of Key Lawsuits Centering on NFTs. The Fashion Law [online]. [no date] [viewed 15 September 2022]. Available from: https://www.thefashionlaw.com/from-hermes-to-bored-apes-a-running-list-of-key-lawsuits-over-nfts/.

[22] MoMA | Andy Warhol. Campbell's Soup Cans. 1962. *MoMA* [online]. [no date] [viewed 15 September 2022]. Available from: https://www.moma.org/learn/moma_learning/andy-warhol-campbells-soup-cans-1962/.

Elle and The New York Post also erroneously reported that Hermès had collaborated with Rothschild to present the NFT MetaBirkins collection. [23]

CONCLUSION

The rise of NFTs has revolutionised the art market and beyond. This trend has attracted a lot of media attention and also investors who have invested huge amounts of money. However, the application of the law, and especially copyright law, to this trend remains a question. Indeed, as is always the case in history, when a new technology appears that is not foreseen by the law. While technology is evolving rapidly, the legislation is insufficient to respond to these changes on time. So far, the courts have also not taken a clear position.

We can then conclude that NFTs cannot be considered unauthorized copies of an original work under applicable law, and therefore cannot be claimed for copyright infringement. Therefore, it will be necessary to make changes to copyright law that address the uniqueness of NFTs.

As long as this issue is not regulated by legislation or covered by relevant court decisions, those operating in the field of art, fashion, and similar need to be aware of the risks, in particular (i) that not all NFTs may contain licence or copyright assignment arrangements, (ii) even if they do, they may not meet the requirements of the relevant legislation, (iii) and above all that the NFT is not the work itself.

Moreover finally, the trademarks need to be considered as well. With the rise of the metaverse and NFTs comes to an unprecedented digital transformation, and brands are struggling to keep up. They are starting to offer virtual products that are digitalized versions of their actual goods that you can put on in the virtual world, and they are also using NFT to sell these virtual products. Therefore, keeping an eye on intellectual property protection in this emerging virtual market is very important.

Brand owners should also consider expanding their trademark registrations to include uses involving NFTs. For example, Nike has applied for trademarks for the manufacture and sale of Nike-branded virtual footwear and clothing. As another example, Walmart filed several trademark applications in December 2021 relating to the manufacture and sale of virtual goods.

NFTs are a significant challenge to intellectual property law, and it will be a long way for everyone involved in the process - authors, collectors, judges and legislators. But isn't that the beauty of technological progress?

[23] United States District Court, S.D. New York: HERMES INTERNATIONAL and HERMES OF PARIS, INC., Plaintiffs, v. MASON ROTHSCHILD, Defendant. Available from: https://www.sdnyblog.com/files/2022/05/22-Civ.-00384-Hermes-v.-Rothchild.pdf.

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[18] CZECH REPUBLIC Act No. 121/2000 Coll., the Act on Copyright, on Rights Related to Copyright and on Amendments to Certain Acts [zákon č. 121/2000 Sb., zákon o právu autorském, o právech souvisejících s právem autorským a o změně některých zákonů]

Evaluating the legal impact of EU economic sanctions on Russia from an EU business perspective

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***Abstract**: In response to the 2022 escalation of Russia's invasion into Ukraine, the European Union has implemented unprecedented sanctions targeting the Russian state, individuals supporting the war effort, and the Russian economy generally. These sanctions are unique in the history of the European Union, not only because of their political context but also because of their breadth and the novel legal instruments used. This paper will explore how these distinctive features might impact businesses working within the European Union.*

***Keywords**: CFSP, European Union, Restrictive Measures, Sanctions, 2022 Russia Invasion Ukraine*

INTRODUCTION

On February 24, 2022, Russia initiated a full-scale invasion of Ukraine including an attempt to seize the capital, Kyiv, as well as strikes across the entire country. While the full-scale invasion, was a continuation of incursions which have been ongoing since 2014, the scale of the new attacks caused a number of countries to adopt or increase sanctions targeting Russia. For its part on February 28th, the European Union stepped up its sanction regime.

By their nature such sanctions not only restrict their targets, but also all businesses connected to the EU. Aspects of the new sanctions, such as expanded lists of targeted individuals, will not create significant disruptions for EU businesses. Other factors such as the increasing instability of EU sanctions policy and a willingness to target individuals not directly connected to the invasion, will require novel approaches from businesses.

The key drivers which create the need for new response to these measures are first, the unprecedented political context of EU sanctions against Russia, the legal barriers that restrain the EU from adopting sanctions, as well as an increasing willingness to break EU norms on targeting sanctions. This article examines these three factors, and then briefly discusses how they might impact businesses.

1. POLITICAL CONTEXT

1.1. Political response to the invasion of Ukraine

The political context of the European Union's response to the full-scale invasion is shaped by the objectives of individuals and institutions who decide if and how to implement sanctions. In the foundational, 1979 article 'Economic Sanctions As a Policy Instrument', Barber highlighted three objectives which sanctions are used to achieve.[1] Barber's framework states that Primary objectives are based on an attempt to influence the actions of the target state, secondary objectives are those intended to influence how the sanctioning body is perceived either domestically or internationally, finally tertiary objectives focus on how the sanctions impact on the wider international system.[2]

As scholars have duly noted, while the second two goals can be hard to measure, they still influence sanctions policies.[3] While current EU sanctions against Russia are directed at objectives in all three of these categories, in contrast to other international episodes, strong reactions from the European population, have created strong incentives for EU actors to use sanctions to appear strong on Russia.

This elevated level of support for an EU response was again apparent in the aftermath of the Russian invasion. A Eurobarometer poll conducted in April 2022 found that 80% of respondents from across the EU approved of 'Economic sanctions against Russia'.[4] Despite staunch overall support for sanctions, current support is not even across the union.

1.2. Political and Economic divisions among member states

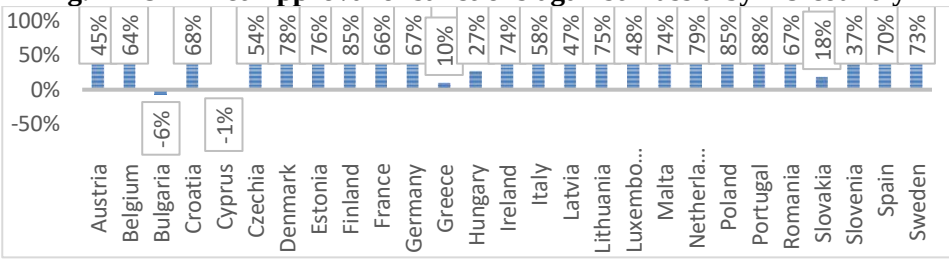
While the citizens of nearly every member state supported sanctions against Russia, Europol data showed collected in April indicated that sanctions had a net negative approval rating in Bulgaria and Cyprus.[5] Support for sanctions was also much more limited in Greece, Hungary, and Slovakia.[6] This trend was

[1] BARBER, James. Economic Sanctions As a Policy Instrument. *International Affairs* 1979, 55(3) p. 370. DOI: 10.2307/2615145.
[2] Ibid.
[3] PORTELA, Clara and PROQUEST (FIRM). *European Union sanctions and foreign policy: when and why do they work?* Milton Park, Abingdon, Oxon [England]; New York; Routledge, 2012, p. 11. DOI: 10.4324/9780203847510.
[4] DIRECTORATE-GENERAL FOR COMMUNICATION. Q4_1 'For each of the following measures that have been announced by the EU to respond to the war in Ukraine, please tell me if you approve them or not. Economic sanctions against Russia.' Flash Eurobarometer FL506: EU's response to the war in Ukraine. data.europa.eu. [Viewed 15 Sept 2022]. Available from: http://data.europa.eu/88u/dataset/S2772_FL506_ENG.
[5] Ibid.
[6] Ibid.

largely mirrored in the subsequent Eurobarometer poll. [7]

Current political differences will also be influenced by long term economic differences. Prior to the full-scale invasion, while Malta and Ireland had almost no trade with Russia, Russia was a key trading partner for the Baltic states and Finland.[8] As shown in Figure 1, the highest level of support for sanctions is also found in the Baltic states and Finland.

Fig. 1 EU 27 Net Approval of sanctions against Russia by EU country



Source: Directorate-General for Communication. April 2022.[9]

While counterintuitive, this is consistent with a 2020 study which showed that the trade with Russia has a slight positive correlation with support for sanctions.[10] Despite the correlation between trade and sanctions support, the different trading relationships with Russia, may also change long-term support for sanctions.

The new wave of sanctions has likely only just begun as previous sanctions episodes have lasted, on average four and a half years, sanctions against Russia for its actions in Ukraine have lasted over 8 years. [11] While the EU has managed to negotiate a common course of action thus far, political and economic differences between the Member States could rupture the EU's sanctions unity.

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[7] DIRECTORATE-GENERAL FOR COMMUNICATION. QE2.1. 'Standard Eurobarometer STD97: Standard Eurobarometer 97 - Summer 2022', data.europa.eu. [Viewed 1 Nov 2022]. Available from: http://data.europa.eu/88u/dataset/S2693_97_5_STD97_ENG.

[8] EURSTAT. EU27 (from 2020) trade by SITC product group (EXT_ST_EU27_2020SITC). [Viewed 15 Sept 2022] Available from: https://ec.europa.eu/eurostat/databrowser/view/ext_ st_eu 27_2020sitc/default/table?lang=en.

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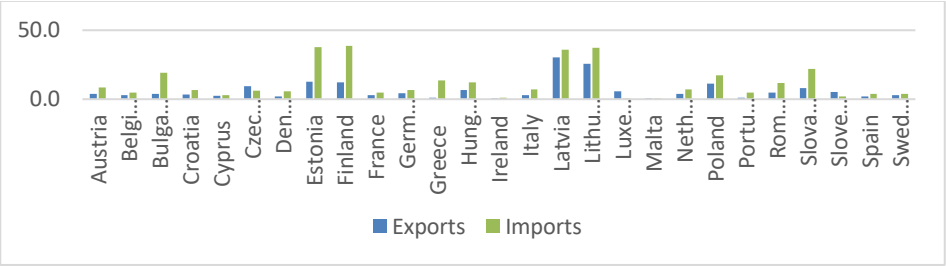
[10] SILVA, Paul and Zachary SELDEN. Economic interdependence and economic sanctions: a case study of European Union sanctions on Russia. *Cambridge Review of International Affairs*. 2019, 33, p. 240. DOI: 10.1080/09557571.2019.1660857.

[11] GIUMELLI, Francesco, Fabian HOFFMANN and Anna KSIĄŻCZAKOVÁ. The when, what, where and why of European Union sanctions. *European Security*. Taylor & Francis, 2021, 30(1) p. 10.

As the next section will show, the EU's founding treaties require it to maintain unanimity to enact sanctions at the union level.

Fig. 2: Percentage of non-EU trade to and from Russia by EU country in 2021



Source: EURSTAT. 2020.12

2. LEGAL BARRIERS

The TFEU (Treaty on the Functioning of the European Union) allows for sanctions against 'natural or legal persons and groups or non-State entities' meaning that sanctions are not strictly limited to states.[13] While sanctions are not listed either as a shared competency or an exclusive competency, scholars note that sanctions are generally treated as within the exclusive competence of the EU.[14] When Member States do attempt to implement their own sanctions they are required to respect the EU's Common Commercial Policy.[15]

The EU implements formal sanctions through its Common Foreign Security Policy (CFSP). General CFSP rules are contained in the Treaty on European Union (TEU) and the TFEU holds the provision regulating sanctions in particular. Both treaties are based on requirements for member state consensus.

2.1. Sanctions within CFSP

Title V of the Treaty on European Union (TEU) governs CFSP.[16] Title V

[12] Ibid.
[13] Article 215(2)
[14] SZABADOS, Tamás. *Economic Sanctions in EU Private International Law* [online]. Oxford: Hart Publishing, 2019, p. 22 [viewed 28.01.2020]. Available from: http://www.bloomsburycollections.com/book/economic-sanctions-in-eu-private-international-law/ch2-the-legal-framework-for-imposing-economic-sanctions/.
[15] *The Queen, ex parte Centro-Com Srl v HM Treasury and Bank of England.* [online]. 1997, para. 27 [viewed 09.12.2022]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61995CJ0124.
[16] See Article 21 TEU.

requires that CFSP decisions be made by the European Council acting on recommendations of the Council (also known as the Council of Ministers).[17] Common Foreign Security Policy decisions to adopt sanctions must be accepted unanimously,[18] but once such a CSFP decision is made, the Council enacts the sanctions with a regulation. Regulations only require a qualified majority.[19]

Fig 3: Simplified depiction of EU Mechanism for adopting sanctions

Source: Author, 2022

These processes leave out the European Parliament, and almost exclusively require unanimity which make them structurally conservative. The EU will not enact sanctions unless all Member States agree.

Per Article 215, the TFEU provision regulating sanctions, decisions to adopt restrictive measures are technically binding on member states.[20] However, in practice the CFSP unanimity requirements mean that Member States' political representatives had to have already agreed in principle before the EU could adopt specific sanctions.

The only exception to this comes from the second part of Article 31 TEU, which would allow a member state to abstain from the vote on sanctions without blocking the decision. The member state would then itself not be bound to follow the decision.[21]

2.2. EU law partially restricts member states from enacting their own sanctions

The structure of the EU also limits the areas that Member States can unilaterally adopt sanctions in. As the CJEU held in Fritz Werner Industrie-Ausrüstungen GmbH v. Federal Republic of Germany; 'a measure […] whose effect is to prevent or restrict the export of certain products, cannot be treated as falling outside the scope of the common commercial policy on the ground that it

[17] See Article 22 TEU.
[18] See Articles 24(1), 31(1), TEU.
[19] See Article 215 TFEU.
[20] See Article 215 TFEU.
[21] Article 31 TEU.

has foreign policy and security objectives.'[22]

Article 347 of the TFEU creates the sole exception by giving member states the ability to respond, '[in cases of] serious internal disturbances affecting the maintenance of law and order, in the event of war, serious international tension constituting a threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security.'[23]

These provisions could be particularly important in the context of the Ukraine conflict, as in contrast to other sanctions episodes, member states would have a clear legal argument that in the absence of collective agreement, certain economic measures targeting Russia are necessary to protect their national security.

Regardless of whether member state division drives the EU to create sanctions with exceptions under Article 31 of the TEU, or Member States to implement unilateral sanctions under Article 347 of the TFEU, the situation is driving Member States to alter longstanding EU norms on sanctions.

3. CHANGING LEGAL NORMS

3.1. Unprecedented Scale

After the full-scale invasion, the EU adopted new sanctions as amendments to the Restrictive Measures package enacted in 2014.[24] Although these packages were adopted as amendments, they are fundamentally different than the original sanctions packages.

Prior to the escalation, the 2014 sanctions regulation targeted individuals, and organizations within areas of Ukraine that Russia had taken control of as well as individuals personally responsible for the violations. At the time the sanctions were also considered some of the most significant EU sanctions packages.[25] While the EU updated the sanctions Directive and Regulation over 25 times, as

[22] *Fritz Werner Industrie-Ausrüstungen GmbH v Federal Republic of Germany* [online]. 1995, para. 10 [viewed 09.12.2022]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/LT/TXT/?uri=CELEX:61994CJ0070.

[23] COUNCIL OF THE EU. *Basic Principles on the Use of Restrictive Measures*. Basic Principle 2; See also *P-002800/2018 Answer given by Vice-President Mogherini* [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:11997E133&from=IT.

[24] *Council Decision No 2014*/512/CFSP of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014D0512. Council Regulation (EU) No. 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine [online]. In EUR-Lex. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0833.

[25] CARDWELL, P.J. The legalisation of european union foreign policy and the use of sanctions. *Cambridge Yearbook of European Legal Studies* [Scopus]. 2015, 17, 287-310 p. 300. DOI: 10.1017/cel.2015.11.

can be seen in the version of the sanctions consolidated prior to the full-scale invasion, these measures did not cover the energy sector which encompasses over 62% of EU trade with Russia.[26]

Following the invasion, despite Russia's ability to prevent UN sanctions by using its Security Council veto,[27] the EU collaborated with the so-called Group of seven,[28] and other allies to quickly coordinate massive international sanctions. For the EU's part, the new sanctions began to target entire sectors of the Russian economy and state.

The EU adopted and strengthened these sanctions progressively through six rounds of restrictive measures as well as, a 'compliance package' and a 'maintenance and alignment' package. The EU has previously implemented Restrictive Measures targeting China, and even the United States, but it is unprecedented for the EU to try to create such a broad economic impact for such a large trading partner. The sanctions now target over 1200 individuals and just over one hundred entities.[29]

3.2. Targeting the Russian population as a whole

Member states have also taken actions which break from longstanding EU guidelines on restrictive measures that guide against targeting a population as a whole. The guidelines state that sanctions should 'minimise adverse consequences for those not responsible for such policies and actions'.[30] The EU's previous understanding is based on the logic of 'smart' or 'targeted' sanctions which are directed at the political actors responsible for the sanctioned behaviour.[31]

In addition to the wide scale, sectoral, sanctions at the EU level, groups of member states have begun discussing novel legal mechanisms to de-facto expand EU sanctions even further. In one example, member states bordering Russia

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[26] *Council Decision No 2014/512/CFSP of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine*. (Consolidated 15/01/2022); EURSTAT. Extra-Euro area trade by partner and by SITC product group' DS-018995. Available from: https://ec.europa.eu/eurostat/databrowser/view/EXT_LT_MAINEZ__custom_3340121/default/bar?lang=en.

[27] Article 29 United Nations Charter, San Fransisco, Oct. 24, 1945. [online]. Available from: https://www.un.org/en/about-us/un-charter/chapter-5.

[28] Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

[29] *Council Regulation (EU) No 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine*. Annex III-IV, XV.

[30] Guidelines on the implementation and evaluation of restrictive measures (sanctions). Council of the European Union. [online]. 2018 [viewed 09.12.2022]. Guideline 13. Available from: https://data.consilium.europa.eu/doc/document/ST-5664-2018-INIT/en/pdf.

[31] HUFBAUER, Gary C and Barbara OEGG. Targeted sanctions: A policy alternative? Law and Policy in International Business [ABI/INFORM Global]. Washington: Georgetown University Law Center, 2000, 32(1) p. 13.

have created de-facto restrictions which make it more difficult for Russian citizens attempting to enter with EU visas.[32] While Portela and other scholars writing before the 2022 invasion, have noted however that the EU did not always strictly target its sanctions, this new development which targets almost all Russian passport holders is a significant development.[33] If such actions are perceived as successful, member states or the EU itself may further coordinate additional restrictive measures targeting Russian citizens at large.

4. THE CURRENT SANCTIONS FROM A BUSINESS PERSPECTIVE

Businesses working in the EU need to consider these factors. Previous assumptions about how European sanctions function, are not valid in the context of recent sanctions directed against Russia. Not only are the sanctions less predictable because, they are likely to follow a fluctuating war, but more importantly sanctions may not follow normal EU procedures.

While previous sanctions episodes are varied, they follow a consistent pattern. The EU enacted sanctions in response to a particular crisis. Based on political processes within the EU, and the actions of the target, EU sanctions could either be expanded to cover more entities, products and conduct or be reduced or eliminated. Sanctions were adopted at the EU level and consistent across the bloc.

In contrast, while sanctions against Russia for the most part adhere to this norm, they are not likely to continue to in the future. Differing levels of support for sanctions between member states are likely to cause subsets of EU member states to enact sanctions. Member states have also demonstrated a willingness to target all sectors of the Russian economy as well as Russian citizens generally.

EU businesses that continue to work with Russia or Russian citizens, will need to review sanctions law not only at the EU level but also at the member state level. Specifically, businesses should consider the possibility that states who have the strongest interest in the conflict including Poland, the Baltic states and Finland may enact unilateral sanctions that restrict remaining ties with Russia. These states are also the EU Member States whose businesses are the most likely to work in Russia.

Conversely states who have not shown as much support for the sanctions, such as Hungary, Bulgaria, and Cyprus may use previously unused provisions of EU law to exempt themselves from future EU sanctions.

EU businesses will also need to prepare for wider sanctions which do not

[32] Olsen, Jan m. 4 nations bordering Russia to restrict Russian tourists. *Associated Press* [online]. 08.09.2022. Available from: https://abcnews.go.com/International/wireStory/nations-bordering-russia-restrict-russian-tourists-89521570.

[33] PORTELA, Clara and PROQUEST (FIRM). European Union sanctions and foreign policy: when and why do they work?. Milton Park, Abingdon, Oxon [England]; New York; Routledge, 2012, 224. 125,128. 9780203847510p.

make exemptions for trade in sectors not connected to the Russian State or military. The political complexities of the situation make it more difficult for even legitimate businesses, trying to operate legally to maintain compliance with all sanctions. While there is not currently a blanket ban on working in Russia or with its citizens, businesses may find it easier to avoid the Russian market entirely.

CONCLUSION

In conclusion, the EU restrictive measures targeting Russia are unprecedented in their scale and shaped by the political processes that will guide EU restrictive measures targeting Russia going forward. These processes are in turn guided by the political reaction to Russia's invasion, the legal barriers to implementing sanctions, the divergent interests of the member states, and a new willingness to circumscribe EU Restrictive Measure norms.

Companies must consider that these factors make business connections to Russia extremely risky for the foreseeable future. Companies must also consider that certain EU countries may choose to target the Union's ability to trade with Russia or interact with its citizens unilaterally.

All these factors make the EU's sanctions against Russia less stable and less predictable from the business perspective. Businesses should respond to these factors by paying closer attention to sanctions policy at the member state level, as well as preparing for unpredictable sudden changes in sanctions policy at the EU level.

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SECTION VI
BANKING, FINANCE AND INSURANCE LAW

The EU Directive on cross-border tax arrangements (DAC6) - the end of tax optimization?

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Abstract: *DAC6 is one of the steps against aggressive tax optimisation adopted by the OECD. The same name is often used to refer to the EU Directive on cross-border tax arrangements (Directive 2018/822) adopted by the European Union. The main objective behind the indicated legislation is to counteract tax optimisation. The paper mainly addresses the effectiveness of the adopted solutions, and the problems arising from them in the context of the laws of the Member States that have implemented the indicated legislation. The methodology of the paper is based analysing and comparing Directive 2018/822 and selected issues from the legislation of the EU Member States. The importance of the work is based on the presentation of the relevant problems faced by Member States in the context of the mandatory disclosure regime (MDR). Preliminary research leads to the conclusion that legislation based on the indicated provisions does not completely eliminate optimisation opportunities but constitutes a significant impediment for all taxpayers - even those not performing optimisation activities.*

Keywords: *DAC6, MDR, tax avoidance, tax optimisation, tax schemes.*

INTRODUCTION

The problem of international income tax optimisation structures has existed since the middle of the twentieth century and intensified most during the period of increased commodity and monetary exchange and the creation of the European single market and common tax system[1]. The problem was only recognised at supranational level in 1977, when the first directive[2] regulating the issue was implemented. Later, with the development of optimisation methods, many attempts were made to create a comprehensive regulation aimed at eliminating or at least limiting the phenomenon described, but the legislation did not keep up with the pace of economic and tax changes and there was a lack of international

[1] A. Krajewska, Podatki w Unii Europejskiej. Harmonizacja czy konkurencja podatkowa?, Radom 2007, p. 255.
[2] Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, as amended (OJ L *336, 27.12.1977, p. 15).*

consensus. Amendments to the 1977 directive were adopted in 2004[3] and 2011[4], but did not have the desired effect.

In 2011, the OECD issued a report[5] in which it proposed a completely novel approach to the problem and advocated the realisation of the issue of tax transparency and openness in international relations.

Despite the indicated attempts to effectively regulate the problem of international optimisation structures, statistical data left no doubt that the measures taken by the EU authorities were ineffective. Indeed, according to the European Commission's 2019 report[6], the total value of budget revenues lost by Member States as a result of international tax evasion amounted to approximately EUR 38 billion in 2004 and remained virtually unchanged after the introduction of the amendment of the same year. Since 2007, however, there has been an abnormal increase in the amount lost, which amounted to approximately EUR 55 billion and remained at a similar level until 2009. The introduction of the 2011 legislation did not bring the intended benefits either, as, according to the same data, the value of forfeited funds continued to rise to reach a peak of approximately EUR 58 billion in 2014.

The result of this report was the so-called "BEPS"[7] Action Plan[8]. This plan identified 15 actions under three critical pillars regarding international taxation. Most EU Member States committed, as OECD members, to implement them. The issues identified were the direct reasons for amending Directive 2011/16/EU and explicitly the BEPS 12 Implementation as Directive 2018/822[9].

1. DAC – WHAT DOES IN MEAN?

The abbreviation DAC[10] is the acronym for a group of activities aimed at

[3] Council directive 2004/106/EC of 16 November 2004 amending Directives 77/799/EEC concerning mutual assistance by the competent authorities of the member states in the field of direct taxation, certain excise duties and taxation of insurance premiums and 92/12/EEC on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products (OJ L 359 4.12.2004, p. 30).

[4] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (OJ L 64, 11.3.2011, p. 1).

[5] Tackling Aggressive Tax Planning through Improved Transparency and Disclosure (OECD, 2011).

[6] European Commission, Directorate-General for Taxation and Customs Union, Bousquet, L., Poniatowski, G., Vellutini, C., et al, Estimating international tax evasion by individuals, Publications Office, 2019, p. 17 https://data.europa.eu/doi/10.2778/86240 (accessed 14 January 2022).

[7] BEPS, eng.: „Base Erosion and Profit Shifting".

[8] OECD report, „Mandatory Disclosure Rules. Action 12: 2015 Final Report" (https://read.oecd-ilibrary.org/taxation/mandatory-disclosure-rules-action-12-2015-final-report_9789264241442-en#page5) (access: 30.08.2022), Paris 2015.

[9] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (OJ L 139, 5.6.2018, p. 1).

[10] Eng. "Directive on Administrative Co-operation".

coordinating actions at EU level to counteract specific negative phenomena of an international nature. In fact, the acronym refers to successive amendments to EU Directive 2011/16/EU, which aim to unify joint actions[11]. Member States undertake to exchange and cooperate on an administrative basis in order to increase their capacity to counteract activities that cannot be detected and eliminated by internal law instruments alone. Examples of such activities are: international tax optimisation (DAC6)[12], fraud (DAC2)[13], lack of transparency of legal entities (DAC5)[14]. Further 'versions' of the Directive are also planned in the future, which will regulate the following areas of the law: exchange of information on income earned through online sharing platforms (DAC 7 - 2023) and exchange of information on income from cryptocurrencies (DAC8 – the date of entry into force unknown)[15].

2. ELIMANTION OF TAX OPTIMISATION AS AN PURPOSE OF DAC6

The questions to be asked in the area indicated are: "Is the taxpayer obliged to pay the highest possible taxes?" and "Where does the limit of legal action end?". According to Polish jurisprudence, a taxpayer is not obliged to apply solutions that will cause them to pay higher taxes[16]. On the other hand, the practice of tax law indicates that if the applicable legal order provides the taxpayer with the possibility to choose several legal constructions to achieve the intended economic objective, each of which will have a different tax dimension, the choice of the most tax-advantageous solution cannot be treated as a circumvention of the law[17]. It follows, therefore, that all activities that fall within the legal activity are permitted and cannot be considered harmful in any way - in line with the principle 'what is not prohibited is allowed'. What actions are therefore illegal? An illegal activity will be such a construction of a legal action, which

[11] Report from the Commission to the European Parliament and the Council 'General overview and evaluation of statistics and information on automatic exchange in the field of direct taxation", Brussels, 17.12.2018.
[12] P. Pantazopoulos, K. Kalampaliki, Country Note: A Critical Approach on the Greek Implementation of the DAC6, Intertax 50/2022, p. 543.
[13] Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (OJ L 359,16.12.2014, p. 1).
[14] Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities (OJ L 342, 16.12.2016, p. 1).
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[17] ZAGROBELNY K., glosa to the judgement of the Supreme Administrative Court of 9 February 2000 I SA /Gd 2036 /97, OSP 2001 No. 10, p. 521.

should be considered as a sham or leading to an abuse of the law[18]. In practice, these will be all actions which have been created in an "artificial"[19] manner, i.e. with the sole purpose of obtaining a tax advantage, without economic justification. Such activities are referred to as 'tax avoidance' or 'tax evasion'.

The Explanatory Memorandum of Directive 2018/822 indicates that the obligation to report MDR tax schemes was introduced to eliminate "aggressive tax planning" or de facto "aggressive tax optimisation". From the analysis of the thesis indicated, it therefore follows that optimisation that does not carry the label "aggressive" is allowed. The problem to be solved is therefore to determine in what "aggressive tax optimisation" manifests itself, once it has been established that "tax optimisation" itself is a legitimate activity. In simple terms, it can be assumed that aggressive tax optimisation consists of the occurrence of actions whose effect is solely to produce tax consequences - it should therefore be considered that one should properly speak of tax avoidance or tax evasion. With this understanding, the tax benefit is an end in itself and not an aspect accompanying an economically justifiable action. An example of such an action could be, for example, locating a business in a territory considered to be a so-called 'tax haven'. The mere choice of a place to open a business cannot yet be qualified as an action bearing the hallmarks of "aggressive optimisation" or "avoidance" or "evasion" of taxation, as such action may be justified by economic and functional reasons. As an example, the creation of a special purpose vehicle located in a country where a business venture in the form of building a hotel in Fiji[20] is being implemented. In order to determine whether such an activity bears the hallmarks of tax avoidance, it is necessary to analyse on what grounds the decision to establish the company in a tax haven was motivated and for what activities it is to be used. In the example described, the activity has a full business and logical justification. However, it would be different if the facility was constructed, for example, in the Czech Republic by a Slovak company transferred to a tax haven. Such an activity could certainly raise doubts about its reliability and business suitability, although it is not excluded that there is a logical justification for such a structure.

3. DAC6 – MODE OF OPERATION

The idea of reporting tax schemes consists of two overarching assumptions. Firstly, it is necessary to detect early the structures used for aggressive tax optimization[21], and secondly, it is necessary to impose a reporting obligation on

[18] Judgment of the WSA in Szczecin of 28.06.2017, I SA/Sz 303/17, LEX No 2335199.
[19] Judgment of the Supreme Administrative Court of 8.07.2019, II FSK 135/19, LEX no. 2769625.
[20] Fiji is one of the countries identified in the EU list of non-cooperative jurisdictions for tax purposes - Council conclusions of 24 February 2022 https://www.consilium.europa.eu/media/54471/council-conclusions-24-february-2022.pdf (access: 10.09.22).
[21] Ministry of Finance, Reporting tax schemes (MDR) - explanations from the Ministry of Finance, LEX/el. 2019.

entities that initiate the creation of these structures, i.e. professional agents (in particular tax professionals)[22]. Detection of the described structures at an early stage, on the other hand, increases the effectiveness of tax authorities in countering these practices and allows for more precise typing of entities for control[23]. The result of such actions is a better allocation of material and personnel resources, which would otherwise be used to try to detect tax avoidance through audits that are carried out "blindly. The measures indicated also have a deterrent function to discourage taxpayers from aggressive optimisation practices. The premise of the measures described is that taxpayers will think twice about embarking on an optimisation strategy if they are forced to disclose it, before the tax authorities, which in turn implies 'self-denunciation'. The MDR provisions also have a direct impact on the tax advice market, as optimisation authors have only limited opportunities to implement schemes before they are closed.

The obligation to report tax schemes applies to two categories of entities - intermediaries and taxpayers[24]. The predominant entities obliged to provide information are intermediaries (called "promoters" in the Polish legal system), i.e. professional entities providing advice on tax law (lawyers, tax advisors). In the Polish legal system, there is also a third category of entities that is not indicated in the directive, these are the "facilitators", i.e. entities that are not "promoters" but participate or may participate in the tax scheme creation process (e.g. notary, accountant, auditor)[25]. These entities also have a reporting obligation in certain cases. According to the definition set out in the Polish Tax Ordinance, the quality of facilitator may be attributed to a person who, with the diligence generally required in the activities performed, taking into account the professional nature of the activity, the area of specialisation and the subject matter of the activities performed, undertook to provide, directly or through other persons, assistance, support or advice concerning the development, marketing, organising, making available for implementation or supervising the implementation of the arrangement[26]. An example of such a situation is, for example, the activities of a notary who will be involved in setting up a chain of capital companies for aggressive tax optimisation. Obviously, the notary in this situation must be aware of the purpose for which these entities are created by him or, based on the circumstances and their knowledge. Facilitators are the category of entities that are last in line for reporting.

It should also be indicated under which circumstances a reportable tax

[22] BIANCO A., DAC6 and the Challenges Arising from Its Disclosure Obligation, EC Tax Review 30/2021, p. 8.
[23] Explanatory Memorandum and Regulatory Impact Assessment for the Government Bill amending the Corporate Income Tax Act, the Personal Income Tax Act and the Tonnage Tax Act of 17.09.2013, 7th legislature. print no. 1725.
[24] Art. 8ab point 1 and 6 of Directive 2018/822.
[25] Art. 86a (1) point 18 Act of 29 August 1997. - Tax Ordinance (Journal of Laws 2021, item 1540, as amended) (Polish Tax Ordinance).
[26] Ibidem.

scheme arises. Firstly, there must occur a certain arrangement, according to the Polish Tax Ordinance, an arrangement is an action or a set of related actions, including a planned action or a set of planned actions, of which at least one party is a taxpayer or which has or may have an effect on the emergence or non-emergence of a tax obligation[27]. An example of an arrangement would therefore be, the conversion of a partnership (or sole proprietorship) into a corporation (limited liability company). Secondly, the arrangement must meet the so-called "main benefit criterion" (although not in every case), according to which if, on the basis of the existing circumstances and facts, it must be assumed that an entity acting reasonably and with legitimate objectives other than the attainment of a tax benefit could reasonably have chosen a different course of action that would not involve the attainment of a tax benefit reasonably expected or resulting from the execution of the arrangement, and the tax benefit is the main or one of the main benefits that the entity expects to obtain from the execution of the arrangement[28]. Translating the indicated circumstance into an example with a company conversion, it should be pointed out that the main benefit criterion will be met only if the main purpose of the company's conversion, was to obtain a tax benefit, i.e. a reduction of tax obligations. However, the feature will not be met if the reason for the transformation is, for example, the circumstance of reduction of investment risk. The last prerequisite for the creation of a tax scheme is the fulfilment of one of the so-called general identifying characteristics indicated in Annex IV to Directive 2018/822. The existence of any of these prerequisites, in combination with the occurrence of the main benefit criterion discussed above, obliges the previously indicated categories of entities to notify a tax scheme. The general identifying features can be divided into two groups of activities that usually accompany the phenomenon of aggressive tax optimisation. The first group is related to the activities of professional attorneys, who determine their fees dependent on the amount of tax benefit obtained thanks to their actions[29]. The second refers to financial transactions and operations aimed at artificially creating a favourable tax situation (e.g. purchase of a loss-making enterprise, different classification of income or circulation of cash[30]). The last category of identifying features does not require the occurrence of the main benefit criterion.

The fulfilment of one of the listed premises is therefore sufficient for the existence of a tax scheme. These premises can again be divided into groups, this time into three. The first group concerns activities of an international nature involving tax havens (e.g. multiple depreciation of the same costs in different countries[31]). The next group concerns activities aimed at eliminating tax information exchange obligations, e.g. the transfer of assets or financial accounts to countries

[27] Art. 86a (1) point 16 of Polish Tax Ordinance.
[28] Art. 86a (2) of Polish Tax Ordinance.
[29] For example, Annex IV part II.A point 2 letter a) of Directive 2018/822.
[30] Annex IV part II.B point 1 of Directive 2018/822.
[31] Annex IV part. II.C point 2 of Directive 2018/822.

that are not bound by agreements on the automatic exchange of financial account information with the country of residence of the taxpayer concerned[32] (TIEA[33])[34]. The last group, on the other hand, relates to irregularities related to transfer pricing documentation (in particular difficult-to-value intangibles[35]).

4. PROBLEMS

The novelty of the MDR rules and the way they operate pose significant problems from a practical point of view - especially in terms of differences in implementation across Member States. The novelty of the rules and their degree of complexity also create numerous interpretive uncertainties, which Member States are trying to eliminate by issuing clarifications on the application of the MDR[36]. The first and, in the author's opinion, the most important problem is the issue of the possibility of breaking the professional secrecy of the public trust professions obliged to inform the tax authorities about the activity of their clients[37]. According to the voices raised by representatives of the legal profession, such a standardisation of regulations is in conflict with the legislation regulating the functioning of professional corporations and with the Constitution itself. Thus, the necessity to disclose information on clients' activities causes a significant decrease in public trust in the indicated professions, which in turn translates into a decrease in the number of clients and the emergence of conflicts. The functioning of the institution of reporting tax schemes calls into question the legitimacy of the tax advisory profession, whose main task is to work towards finding the most convenient tax law solutions for clients. The importance of the problem is evidenced by the fact that the Polish National Chamber of Tax Advisers has filed a motion to examine the provisions of the MDR with the Constitution of the Republic of Poland[38]. A similar action was taken by Belgian tax advisers, on whose initiative an application was submitted to the Court of Justice of the EU

[32] Annex IV part. II.D point 1 of Directive 2018/822.
[33] Eng. Tax Information Exchange Agreement.
[34] For example, Poland has not concluded a TIEA with the Kingdom of Bahrain and Hong Kong - see the list of TIEAs concluded by Poland https://www.podatki.gov.pl/podatkowa-wspolpraca-miedzynarodowa/wykaz-umow-o-wymianie-informacji-w-sprawach-podatkowych/ (access: 11.09.22).
[35] Annex IV part. II.E point 2 of Directive 2018/822.
[36] D. Weber, J. Steenbergen, The (Absence of) Member State Autonomy in the Interpretation of DAC6: A Call for EU Guidance, EC Tax Review 30/2022, p. 254.
[37] See position paper of the Belgian Association of Tax Advisers on professional secrecy in the context of MDR obligations https://www.tiberghien.com/images/publications/BATL_-_NIEUWS BRIEF_2020_2.pdf (access 10.09.22).
[38] Motion of the National Chamber of Tax Advisers to examine the constitutionality of the MDR provisions addressed to the Constitutional Court as an annex to KIDP Resolution No. 618/2019 of 17 December 2019.

(CJEU) to examine the compliance of the MDR provisions with EU law[39]. The Advocate General of the CJEU, on the other hand, stated in his opinion that, in certain circumstances, the DAC6 provisions may violate professional secrecy[40].

Another problem that exists with regard to MDR is the differences in the implementation of Directive 2018/822 in the legal orders of individual Member States. A doubt arises in this respect in the form of the relation of implementation differences to remaining in compliance with the purpose of the institution and the intention of the EU legislator. The largest number of 'sui generis' institutions exists in this respect in the Polish legal order. The main doubt in this respect is the introduction of an obligation to report 'domestic tax schemes', i.e. solutions without international elements in their structure. This is because, as pointed out at an earlier stage of the article, tax schemes are supposed to counteract the erosion of taxation on international grounds. Therefore, doubts arise as to whether the Polish legislator did not exceed the freedom of implementation of the directive[41] (and thus did not implement the legislation in an arbitrary manner). Since the EU legislator limited itself to foreign schemes, it should be concluded that domestic schemes - should not be subject to reporting. Reporting of domestic schemes is also present in the Portuguese legal order[42] and in the UK legislation[43], but reporting of tax avoidance activities within national law which occurs in Ireland and the UK do not arise from the implementation of Directive 2018/822 and operate under different rules. Numerous controversies in this respect are also caused by the different catalogue of identifying features indicated in the Polish Tax Ordinance[44] and the obligation to create a so-called 'internal procedure'[45] for MDR sanctioning rules on how to deal with the reporting of tax schemes in entities where the risk of their occurrence is high. Again, the existence of these institutions does not follow from the provisions of Directive 2018/822.

CONCLUSION

In line with the assumptions made, it should be pointed out that although

[39] Case of Orde van Vlaamse Balies and others, C-694/20, OJ EU C 128/10, 12.4.2021 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62020CN0694&qid=1661503344479 (access 10.09.22).
[40] Opinion of Advocate General Athanasios Rantos of 5 April 2022 in Case C-694/20 https://eur-lex.europa.eu/legal-content/PL/TXT/HTML/?uri=CELEX:62020CC0694&from=en#Footnote1 (access 10.09.22).
[41] A. Ladzinski, D. Wasiluk, Incorrects of implementation of Directive 2018/822 (MDR) and its consequences, Tax Review 2019, no. 5, pp. 9-16.
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[43] See: https://www.gov.uk/guidance/disclosure-of-tax-avoidance-schemes-overview (access: 10. 09.22).
[44] Art. 86a § 1 point 1 Polish Tax Ordinance.
[45] Art. 86l § 1 Polish Tax Ordinance.

indeed the DAC6 is one of the landmark steps against aggressive tax optimisation, this legislation is not free of problems and shortcomings. Despite the fact that the basic assumptions underlying the indicated legislation are correct, it should be emphasised that the elimination of international tax optimisation still requires increased control activity in the internal activities of states and intensive international cooperation in the exchange of tax information. The legitimacy of the described solutions is questioned mainly in terms of: the protection of professional secrecy of entities obliged to report, the severity of penalties and the differences in implementation in individual EU Member States. As indicated in the article, the problem of violation of professional secrecy is noted in at least several countries, as well as at the level of the CJEU, which proves the actual existence of this problem and the necessity to solve it. The severity of penalties is another aspect that does not correspond to the objectives of Directive 2018/822, mainly due to the breach of the proportionality requirement in some countries. Finally, the problem of the inaccurate implementation of Directive 2018/822 into national orders, disregarding the probable intention of the EU legislator to report only cross-border solutions.

The considerations described lead to the clear conclusion that the provisions of Directive 2018/822 need to be clarified and amended especially in the problematic aspects raised. In this respect, there is a possibility that the correct functioning of the institutions will be shaped by appropriate official practice, assisted by national and CJEU case law. The problem of professional secrecy should find a solution in a CJEU ruling, which, as of the date of writing, has not yet been made.

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MiFIR Review proposal: Americanization of EU financial markets?

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Abstract: *This contribution aims to discuss the recent proposal to review Regulation (EU) No. 600/2014. The European Commission proposed to establish the consolidated tape in the European Union and increase transparency for investors in the EU financial markets. The EU is struggling to attract non-EU investors in the last few years. The proposal puts on the table legislative changes similar to those that are in place in the United States for more than a decade. The question is whether the EU is getting inspired by the regulation on the other side of the Atlantic Ocean in order to help financial markets in the EU. The contribution shall discuss the Markets in Financial Instruments Regulation (MiFIR) Review proposal and find if the European consolidated tape can copy the American model.*

Keywords: *Consolidated tape, CMU, EU financial markets, MiFIR Review.*

INTRODUCTION

The European Commission published on 25 November 2021 a legislative package in line with its political priorities in building the Capital Market Union to help European business to raise capital. A proposal for a Review of the Markets in Financial Instruments Regulation[1] (MiFIR Review) brings on the table an introduction to "European consolidated tape." This measure on the financial market has been discussed in the EU since the draft directive on markets in financial instruments (MiFID II) was proposed by the Commission in 2014 yet has not been put in place. The review is not a complete recast, but it does specifically address certain areas to enhance capital market functionality in the EU. The proposal aims to remove some of the existing obstacles in the EU financial market. The proposal includes measures to increase transparency, to create a single picture of the EU market by creating a consolidated tape for asset classes and to ban certain business models of financial intermediaries[2] that increase transaction

[1] A proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.
[2] Payment for order flow (PFOF) is the practise used on some German markets.

costs for consumers. The appetite to take inspiration from the United States and Americanise the EU's financial markets in an attempt to kick-start economic growth has existed in Europe for more than a decade. Is it time to apply American 'good practice' to the European Union? This paper shall investigate if the "European Consolidated Tape" is in practice an American model transferred to the EU market. This paper shall provide a comparative picture of the consolidated tape by using the method of a comparative legal analysis applied on the recent legislative proposal.

1. CAPITAL MARKET UNION

The Capital Market Union (CMU) has been identified as a Union's priory early in 2015. While the EU single market has been achieved in many areas, the financial markets remained fragmented. On 15 September 2015, the European Commission adopted the First Action plan[3] with a clearly defined objective: to remove barriers in order to provide more funding choices for Europe's businesses using a step-by-step approach. Despite a number of legislative initiatives taken by the Junker Commission[4] an EU single capital market has not been reached.[5] The new Action Plan was adopted on 24 September 2020 under the von der Leyen Commission[6]. The integration of national capital markets into an EU single genuine market is to be achieved through a series of legislative measures.

Three objectives of the action plan consist of post-pandemic recovery and green and digital transformation, a safer investment environment for individuals, and the integration of national capital markets. Regarding the third objective, the Commission aims to build the capital market union by adopting seven measures. Initiatives defined by the Commission aim to harmonize some national rules, facilitate the exercise of shareholder rights, review cross-border settlement services, build the consolidated tape to increase transparency in the market, strengthen investment protection in the EU, and converge the supervision by a

[3] COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS Action Plan on Building a Capital Markets Union.

[4] There were numerous legal acts that were adopted such as Regulation (EU) 2017/2402. Securitisation Regulation, Regulation (EU) 2017/1129 on Prospectus, and Regulation (EU) 2020/1503 on Crowdfunding., Regulation (EU) No. 648/2012, EMIR.

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single set of directly applicable rules within the EU.[7]

The idea of a single capital market in the EU rests on the elimination of differences between national markets so that the Union represents a single securities market for issuers and foreign investors. Given the multiple constraints in the EU, such as increasing national indebtedness, shaky economic growth, and high costs related to the political ambitions toward a carbon-free economy, EU regulators are forced to look for ways to foster economic growth.[8] Integrating capital markets and creating uniform rules so that the EU constitutes one market for investors is an empirically sound way to foster economic growth.[9] More investors shall support the post-pandemic economic recovery and the transformation to a green and digital economy. The capital union is considerably more sensitive to external economic shocks than the monetary union, while uniform rules and increased transparency may reduce competition in favor of larger EU players at the expense of smaller (local) financial institutions.[10]

2. THE EUROPEAN CONSOLIDATED TAPE

The consolidated tape (CT) refers to an electronic tool that collects market data (i.e. transaction price and volume) from various financial market participants (exchange-listed), which is made available to investors or other relevant market participants through a single location in a standardized format. That means the collection, processing and publication of financial market data. Such technology has traditionally been used by developed financial markets, such as the United States to improve the performance of financial markets. US stock markets are key engines of economic growth.[11] Unlike the United States, the European Union is a more fragmented entity with an incomplete monetary union.

2.1. Legal basis for the consolidated tape under MiFID II

The idea of introducing a consolidated tape in the EU was legislated

[7] Ibid.

[8] QUAGLIA, Lucia & HOWARTH, David & LIEBE, Moritz. The Political Economy of European Capital Markets Union: European Capital Markets Union. JCMS: Journal of Common Market Studies. 54. 2016. 185-203.

[9] OPREA, Otilia-Roxana, and Ovidiu STOICA. Capital Markets Integration and Economic Growth. Montenegrin Journal of Economics [online]. 2018, 14(3), 23–35 [viewed 30 September 2022]. ISSN 1800-6698.

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[11] KAVESH, Robert A., Kenneth D. GARBADE, and William L. SILBER. TECHNOLOGY, COMMUNICATION AND THE PERFORMANCE OF FINANCIAL MARKETS: 1840-1975. The Journal of Finance [online]. 1978, 33(3), 819–832 [viewed 30 September 2022]. ISSN 0022-1082.

within the adoption of MiFID II[12] in 2014 (effective from January 2018[13]). As part of the EU legislators' efforts to increase transparency in EU financial markets, one of the objectives of this Directive was to create a consolidated tape.[14] Recital 117 called for the creation of the tape "*as soon as possible*", while at the same time envisaging a "*commercially viable*" solution.[15] The Directive envisioned the creation of a tape for both equity and non-equity instruments, with a solution for equities considered to be easier to achieve compared to a tape for bonds at the time of the drafting of the legislation. The directive defined a "*consolidated tape provider"* (CTP) in Art. 4 (53). The CTP should have collected and aggregated data to provide a single picture of the EU market. The designation of the CTP was to be done through public procurement. MiFID II also empowered the European Securities and Markets Authority (ESMA) to issue regulatory technical standards for CTPs under Art. 65 (8) MiFID II.[16] Although the MiFID II rules "created" the consolidated tape at the legislative level, market participants did not move the concept from paper to reality. Indeed, the resistance of private companies to share trading data strongly distorted the business model, so the willingness to provide data cheaply was low. The volume of data provided suffered from delays[17] and lack of standardization. Thus, the MiFID II rules failed to live up to the legislator's intention of "commercial viability" as the concept did not create enough room for CTPs to make any profit. Therefore, the European consolidated tape has not been successful yet.[18]

2.2. Solution under MiFIR Review

Having past attempts for a consolidated tape as part of MiFID II in mind, the European Commission presented a proposal for the creation of a CT under

[12] 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.
[13] The provisions related to non-equities under Art. 65(2) applicable as from September 2019.
[14] EXPLANATORY MEMORANDUM, A proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.
[15] See Recital 118 MiFID II.
[16] Commission Delegated Regulation (EU) 2017/571 of 2 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the authorisation, organisational requirements and the publication of transactions for data reporting services providers.
[17] Data should be provided to the CTP with 15 mins delay under Art. 65 (1) second subparagraph, (2) second subparagraph.
[18] BUSCH, Danny. MiFID II and MiFIR: stricter rules for the EU financial markets. Law and Financial Markets Review[online]. 2017, 11(2-3), 126–142 [viewed 30 September 2022]. ISSN 1752-1459.

MiFIR Review[19]. The explanatory memorandum, based on the analyses carried out by ESMA, stated that the objective was not achieved by means of MiFID II and MiFIR.[20] Unlike previous legislative attempts, the European Commission's proposal is based on the principle of mandatory data contribution to the consolidated tape and the revenue sharing mechanism. According to Article 1 (10) which inserts new articles 22a – 22c to MiFIR, most of financial market participants shall have the obligation to make mandatory contribution to the consolidated tape.[21] Unlike MiFID II, the proposal envisages a remuneration mechanism for all contributors to make the CT project viable. According to Article 1 (16) (c)(new Article 27h), the CTP is obliged to apply a revenue-sharing mechanism for CT for shares between regulated markets.[22] The proposal presumed a mandate for ESMA to determine the CTP using a public procurement under Art. 1 (15) MiFIR Review (inserted Art 27da). At the same time, technical specifications are expected using regulatory technical standards that will be adopted by ESMA.[23] [24]

The design of the consolidated tape can be characterized by five attributes. First, the CT in the EU shall be based only on post-trade data, i.e. historical data about executed trades. The proposal does not envisage including pre-trade data. While post-trade data indicate historical direction, pre-trade data indicate current market sentiment and encourage competition. Second, the consolidated tape is designed to be "close-to real-time". Unlike the current transparency rules, where there is an obligation to report data with a 15-minute delay. The proposal seems to be more ambitious in this respect. Third, the proposal is based on mandatory data contribution. Contrary to 2014 efforts, which assumed that market actors would have been motivated by profit-making and did impose mandatory reporting in a limited way. This time the lawmaker's intention is to avoid further setbacks and go the route of imposing a new obligation. Fourth, the consolidated

[19] EXPLANATORY MEMORANDUM, A proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No. 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.
[20] STAFFORD, Philip. EU aims to unify capital markets with live trading databases. Financial Times[online]. 23 May 2022 [viewed 30 September 2022].
[21] Data contributors are subject to legislative debate, it shall apply to Regulated Markets (RMs), Systemic Internalizes (Sis) through Approved Publication Arrangements (APAs), Multilateral Trading Facilities (MTFs), Organised Trading Facilities (OTFs) in case of non-equities.
[22] COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT REPORT Accompanying the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No. 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.
[23] EXPLANATORY MEMORANDUM, A proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No. 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.
[24] ESMA. MiFID II/MiFIR Review Report No. 1 On the development in prices for pre- and post-trade data and on the consolidated tape for equity instruments. 5 December 2019.

tape will distribute revenues. Although the Commission envisages mandatory data contribution, the effort is to mitigate the negative impact on small entities (regulated markets).[25] The creation of a revenue-sharing mechanism is intended to compensate for losses caused by the inability to sell the data. The current business model of market players is based on data selling. According to the proposal, the consolidated tape will provide this data free of charge to the public.[26] Fifth, the proposal foresees the creation of a consolidated tape for all asset classes and the designation of a single CTP for each class. (Stocks, ETFs, bonds, derivatives).[27] Unlike MiFID II, CT prioritization for bonds can be expected.[28]

3. INSPIRATION BY THE AMERICAN MODEL

The consolidated tape has its roots in the United States in the 1970s. Hence, the logical, not necessarily correct, approach to policy-making in the EU is merely to look across the Atlantic ocean. The US economy has traditionally had a strong tradition of investments and financial markets.[29] The CT was gradually introduced, starting with equities in 1970 and being completed in 2002 by non-equities tape (incl. corporate bonds). The current design of the US tape is based on mandatory reporting for all securities listed on US exchanges. Regardless of the execution venue, the data is submitted via the Trade Reporting Facility (TRF), which guarantees the required data quality. Fixed income over-the-counter (OTC) securities must be reported through the Trade and Reporting Compliance Engine (TRACE) no later than 15 minutes after execution. Similar to the EU model, the US CT is built on mandatory reporting for all market participants. Unlike the EU proposal, there is no revenue-sharing model in the US. In addition, CT in the US is also used to determine the Best Bid and Offer,[30] which provides investors with an improved investment decision by having information on the

[25] IORDACHE, Irina Diana. Information Transparency on Financial Markets, an International View. Audit Financiar[online]. 2020, 18(159), 568–577 [viewed 30 September 2022]. ISSN 1844-8801.

[26] The revenue-sharing mechanism is to be based on the principle of rewarding the fullfilment of key market functions (listing, pricing, etc.). Yet the mechanism is still under discussion in the legislative process.

[27] EXPLANATORY MEMORANDUM, A proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.

[28] EUROPEAN COMMISSION, Directorate-General for Financial Stability, Financial Services and Capital Markets Union, The study on the creation of an EU consolidated tape: final report, Publications Office, 2020.

[29] U.S. SECURITIES AND EXCHANGE COMMISSION. Consolidated tape. [viewed 30 Septtember 2022].

[30] TIVNAN, Brian, et al. Price Discovery and the Accuracy of Consolidated Data Feeds in the U.S. Equity Markets. Journal of Risk and Financial Management [online]. 2018, 11(4), 73.

best possible price for a given volume at a given time on the market.[31]

The US consolidated tape cannot easily be imported into the EU for several reasons. Firstly, the economic integration of the EU is way lower compared to the United States. In the EU we may speak of the currency union with harmonized financial markets rules only. Secondly, the benefits of CT in the EU will necessarily be limited by geographic proximity between trading venues.[32] The technical delays in data transmission in Europe between financial capitals will always be greater than in the case of major financial centres in the US. Furthermore, the EU financial market is characterized by a large number of trading venues and small markets, whereas the US is a compact market with few major venues. Furthermore, the EU financial market is less liquid and has a relatively higher share of smaller transactions.[33] Finally, there is a significant legislative and regulatory gap. While the US market is organized at the federal level with a central supervisory authority (FINCA, SEC) and financial market rules at the federal level, the European Union is still "just" a single market comprised of 27 Member States with different jurisdictions. Each Member State has its own (at least one) supervisory authority (NCA).[34] Similarly, there are no uniform rules for securities (different rules for issuing bonds).

CONCLUSION

A consolidated tape in the EU will always have a larger technical latency. Regarding equities, the European consolidated tape comparable to the US model is achievable; for bonds, however, the different legislation for bond issuance and the specificities of individual markets will be an obstacle. Mandatory data reporting seems to be necessary for making CT real. On the other hand, it may lead to greater market concentration in the EU. Local exchanges will be forced either to find a new business model or to leave the market as revenues from data selling will be minimized if CT real-time is put in place. Last but not least, the functionality of the consolidated tape would require an extension of the supervisory powers of EU authorities (in particular ESMA) at the expense of national supervisory authorities in each Member State, which is politically unlikely to be feasible. However, it can be concluded that the proposed revision of MiFIR is likely to

[31] TEMPELMAN, Jerry H. Price Transparency in the U.S. Corporate Bond Markets. The Journal of Portfolio Management [online]. 2009, 35(3), 27–33 [viewed 2 October 2022].

[32] COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT REPORT Accompanying the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 600/2014 as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders.

[33] SAPIR, A., VÉRON, N. & WOLFF, G.B. 2018, 'Making a Reality of Europe's Capital Markets Union', Policy Contribution, issue no. 07, April 2018.

[34] The willingness of Member States to confer additional powers on ESMA is limitied by polical reluctance to give up national supervisory powers to the EU.

finally result in the establishment of the European consolidated tape. However, despite the clear inspiration from the US model, the nature of the European consolidated tape is different.

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[7] SAPIR, A., VÉRON, N. & WOLFF, G.B. 2018, 'Making a Reality of Europe's Capital Markets Union', Policy Contribution, issue no. 07, April 2018, http://bruegel.org/wp-content/uploads/2018/04/pc-07-2018.pdf.

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[9] TEMPELMAN, Jerry H. Price Transparency in the U.S. Corporate Bond Markets. The Journal of Portfolio Management[online]. 2009, 35(3), 27–33 [viewed 2 October 2022]. ISSN 2168-8656. Available from: doi:10.3905/jpm.2009.35.3.027.

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